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TAX FOUNDATION'S VOL. 33, NO. 5 SEPTEMBER/OCTOBER 1989

TAX·FEATURES

Tax Foundation Looking Forward to 50 More Years

Foundation's Key Programs and Research to Continue

Median Family's Disposable Income Falls in 1989; Rising Inflation and Taxes End 7-Year Streak of Increases

Accelerating inflation and direct federal taxes will outpace the growth of the U.S. family's income, reducing its purchasing power in 1989. A typical family — a household with two earners employed full-time, year-round with two dependent children — will experience a net decrease in real income of $152 in 1989 after adjusting for direct federal taxes. This is the first decline seen in seven years, as real family income after direct federal taxes had been increasing an average of $633 a year since 1982.

The two-earner family that made $29,627 in 1980 is now earning an estimated $49,326. However, taking direct federal taxes and inflation into account, the $19,699 increase in this family's income between 1980 and 1989 resulted in only a $3,639 net gain. Over 80 percent of increased income has been eroded by direct federal taxes and inflation.

Federal Taxes

Since 1980, the federal income tax paid by the median family has risen 52.2 percent despite two major income tax changes in 1981 and 1986. These legislative tax reductions have helped lighten the burden, but have not nearly offset the increased tax receipts caused by income growth and inflation. The federal income tax, which claimed 13.7 percent of the family's total income in 1980, fell to a low of 11.8 percent in 1985 but has quickly rebounded to 12.5 percent.

The bite that Social Security takes out of the typical family's income has increased more steadily — at $3,684 in 1989, it is more than double the $1,816 paid in 1980. Social Security

(See AVERAGE FAMILY on page 2)

The Tax Foundation is pleased to announce a new arrangement to continue its research and programs as a separate unit of the Citizens for a Sound Economy Foundation (CSEF). The independent research that became the hallmark of the Tax Foundation will continue in the tradition of its 50-year history.

James Q. Riordan, former chairman of the Tax Foundation, and James C. Miller III, former Director of the Office of Management and Budget and current chairman of CSE, will serve as co-chairmen of a policy council, now in formation, which will include many current trustees of the Tax Foundation: Richard J. Hiegel, M. Alanson Johnson II, W. Bruce Thomas, Hans W. Wanders, Edward L. Addison, Roland M. Bixler, The Hon. Harry F. Byrd, Jr., Dr. John C. Burton, and Kenneth Iverson. Wayne Gable will be the president of the new entity, and the new Tax Foundation offices will be located at L'Enfant Plaza in Washington.

The new Tax Foundation executives stressed that maintaining the objective research and programs of the Tax Foundation is their number one concern. "The Tax Foundation has carved out a special role in the policy community over its 50-year history, and it is an important role," said Mr. Gable. "We want to see its programs and its invaluable research continue."

At the same time, the Tax Foundation has gained the energy and talents of professionals committed to its success. Daniel Witt will head development efforts and David Makarechian will direct research, publications, and other Tax Foundation programs. Mr. Riordan remarked, "CSEF shares our commitment to the maintenance of the objectivity, fairness, and integrity of the Tax Foundation's research and programs."

The Tax Foundation is completing projects slated for 1989 and is planning an ambitious program for 1990. *Tax Features* will resume a monthly publication schedule, and the twenty-fifth edition of *Facts and Figures on Government Finance* will be available soon. Robert F. Hannon and Glenn W. White have agreed to chair a Program Committee that will advise the Tax Foundation on conferences, publications, and special studies.

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will claim 7.5 percent of the family's 1989 earnings, up from 6.1 percent in 1980. These direct federal taxes will absorb 20 percent of family income, down only slightly from the 1981 peak of 20.3 percent.

Inflation

The upswing in inflation is the most significant reason for the decline in the typical family's purchasing power in 1989. Inflation, which stood at 13.5 percent in 1980, had declined fairly steadily to a low of 1.9 percent in 1986, giving the growth rate in family income a chance to outpace inflation during this period. But subsequently, inflation accelerated and has already exceeded 5 percent in the first half of 1989. If inflation had just remained at its 1988 level of 4.1 percent, this family would have realized a $178 net increase in real income instead of a $152 loss.

The sizable 66 percent nominal income gain the two-earner family has made since 1980 has been reduced to only a 10.2 percent gain after direct federal taxes and inflation are taken into account. Other indirect federal taxes and state and local tax increases not shown here have further offset the family's increased earnings.

The accompanying table and chart provide additional details on the fate of family income since 1980.

Median Family Income Before and After Direct Federal Taxes and Inflation

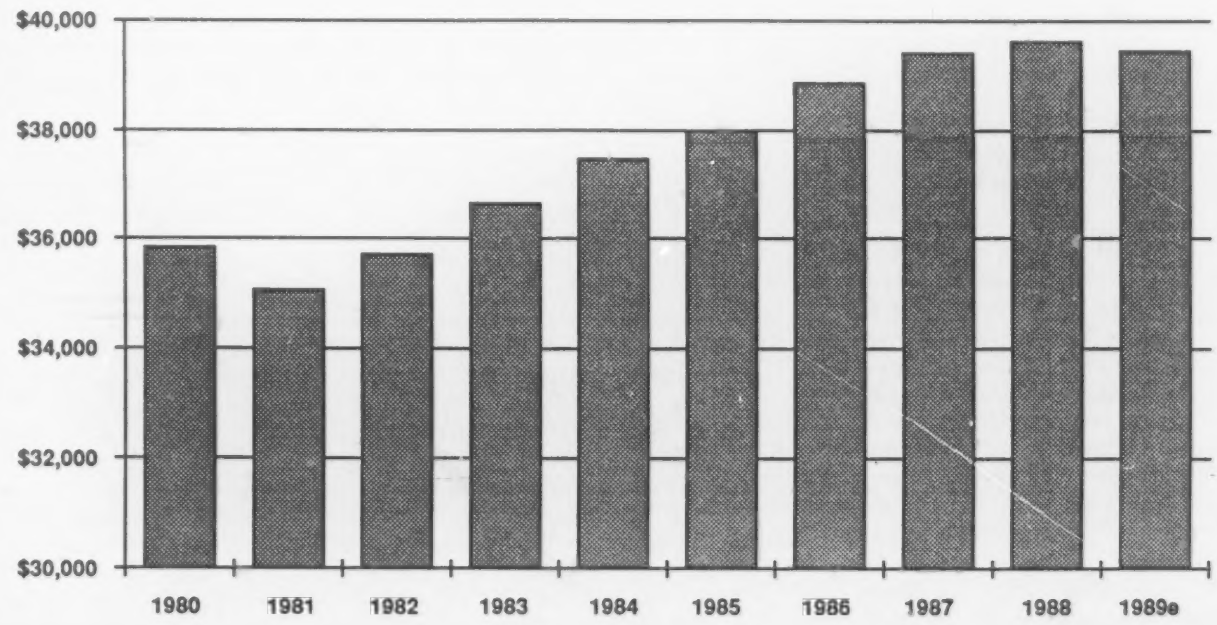
1980-1989

Year	Two-Earner Median Family Income[a]	Direct Federal Taxes: Income Tax[b]	Direct Federal Taxes: Social Security	Direct Federal Taxes: Total	After-Tax Income: Current Dollars	After-Tax Income: 1989 Dollars[c]
1980	$ 29,627	$ 4,050	$ 1,816	$ 5,866	$ 23,761	$ 35,839
1981	32,224	4,386	2,143	6,529	25,695	35,102
1982	34,515	4,450	2,313	6,763	27,752	35,717
1983	36,106	4,300	2,419	6,719	29,387	36,642
1984	38,713	4,634	2,710	7,344	31,369	37,478
1985	40,593	4,787	2,862	7,649	32,944	38,042
1986	42,492	5,158	3,038	8,196	34,296	38,884
1987	44,536	5,291	3,184	8,475	36,061	39,411
1988[d]	46,870	5,632	3,510	9,142	37,728	39,630
1989[d]	49,326	6,164	3,684	9,848	39,478	39,478

[a] Median income for household with two earners employed full-time, year round.
[b] Married couple filing joint return, two dependent children.
[c] Adjusted by consumer price index, estimated 5% inflation in 1989.
[d] Estimate.
Source: U.S. Department of Commerce, Bureau of the Census; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Treasury Department, Internal Revenue Service, and Tax Foundation.

Median Family Income After Direct Federal Taxes and Inflation

1980 - 1989



U.S. Health Bill Grabs 15 Cents of Each Tax Dollar

Costs Will Surpass Social Security and National Defense Combined!

Will Americans be three times healthier in 10 years? Probably not. However, national health expenditures are expected to triple by the year 2000.

The U.S. spent a record $500 billion on health care in 1987, a 9.8 percent increase over the 1986 level and nearly 12 times the amount spent in 1965, according to the most recent statistics available. Federal, state and local governments picked up $207 billion of the health-expense tab, with 70 percent ($145 billion) of the total coming from Uncle Sam. State and local governments anted up the remaining $62 billion.

National health expenditures are expected to triple by the year 2000.

Per capita health spending has reached a level of $1,987, nearly ten times the per capita spending in 1965. Since 1975, tax funds have provided about 42 cents of every dollar spent on the nation's sharply rising health bills. In 1965, taxes furnished only 26 cents. The tremendous tax burden caused by government health costs shows no signs of abating.

To get a clear picture of how enormous our health outlays have become, health costs have nearly doubled, as a percent of gross national product (GNP), from 5.9 percent of GNP in 1965 to 11.1 percent in 1987 — higher than any other industrial nation. Unfortunately, this will still not be enough!

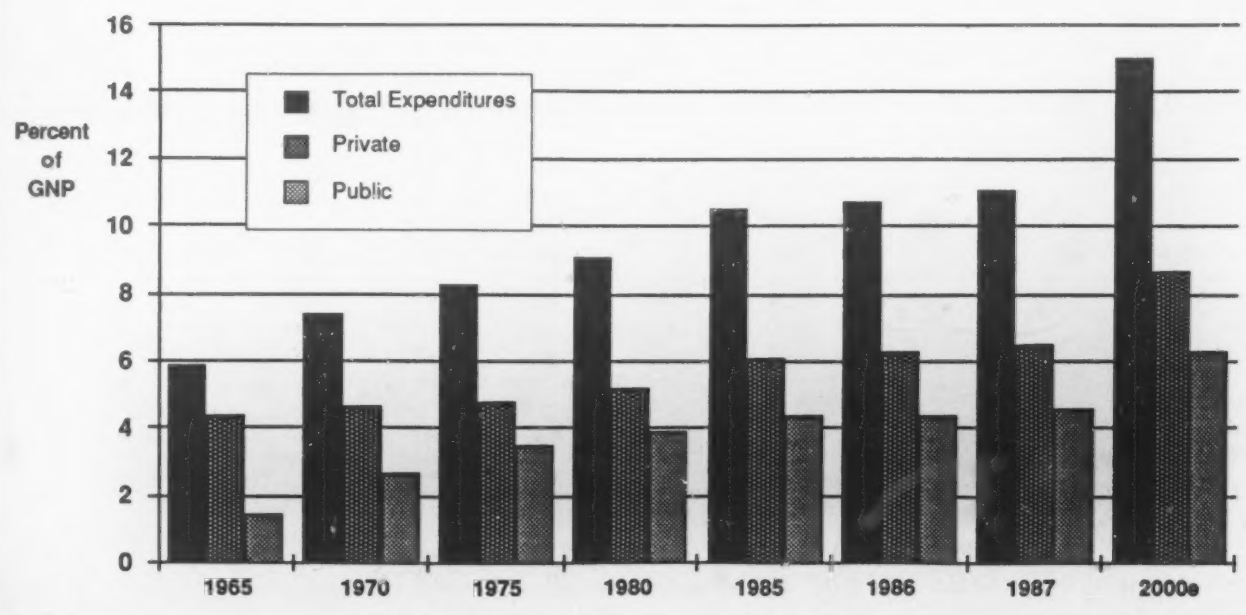
The Health Care Financing Administration (HCFA) estimates the nation's health costs and projects health expenditures will reach $1.5 trillion by the year 2000 — a whopping 15 percent of GNP or $5,551 for every man, woman, and child. The numbers reveal the story of how steadily Uncle Sam's involvement in health care has grown over the years. Federal health spending has grown much faster than medical spending generally. In 1987 private health spending was 9 times its 1965 level and state/local spending was 11 times greater, but federal spending grew 26-fold during this same period. Publicly funded health programs today claim 15 cents of every government tax dollar, as opposed to only 6 cents in 1965.

Publicly funded health programs today claim 15 cents of every government tax dollar, as opposed to only 6 cents in 1965.

Despite initiatives during the 1980s to reduce public health costs, budget cuts and cost control measures have had a limited effect on the

(See HEALTH COSTS on page 4)

National Health Expenditures as a Percentage of GNP
Selected Years 1965 - 2000e



(HEALTH COSTS from page 3)

spiraling costs of government health programs. Medicare and Medicaid are the engines driving the sharp growth of government health costs. These two largest government health programs, enacted by Congress in 1965, now account for 28 percent of the total health care bill for all Americans. Medicare alone has become the largest purchaser of health-care services in this country. The federal Medicare program, which now serves over 33 million elderly and disabled Americans is projected to cost more than Social Security and national defense combined within 25 years.

The Medicare Dilemma

In 1983 Congress helped slow down the growth rate in Part A Medicare by imposing a system of paying pre-set amounts for specified ailments and clamping down on annual

(See HEALTH COSTS on page 5)

National Health Expenditures by Source of Funds and Type

Selected Calendar Years 1965 - 2000

	1965	1970	1975	1980	1985	1986	1987	2000[e]
A. Amount ($Billions)								
Total expenditures	$ 41.7	$ 75.0	$ 132.7	$ 248.1	$ 419.0	$ 455.7	$ 500.3	$ 1,529.3
Private expenditures, total	31.0	47.2	76.4	142.9	244.0	266.8	293.0	879.4
Health services and supplies	29.5	44.7	73.0	138.7	238.0	260.5	286.7	
Direct payments	18.5	26.5	38.1	63.0	103.7	112.6	123.0	
Insurance premiums[a]	10.0	16.9	33.2	72.6	129.1	142.4	157.8	
Other	1.0	1.3	1.8	3.0	5.2	5.5	5.9	
Medical research	.2	.2	.3	.3	.5	.7	.8	
Medical facilities construction	1.3	2.3	3.1	4.0	5.5	5.6	5.7	
Public expenditures, total	10.8	27.8	56.3	105.2	175.0	188.9	207.3	649.9
Health services and supplies	8.8	24.9	51.3	97.5	165.4	178.8	196.5	
OASDHI (Medicare)	-	7.5	16.3	36.8	72.3	78.7	85.4	
Temporary disability insurance[b]	.1	.1	.1	.1	.1	.2	.2	
Workers' compensation[b]	.8	1.4	2.4	5.2	8.0	8.5	9.0	
Public assistance medical payments[c]	2.1	6.3	15.1	28.1	42.0	46.8	52.3	
Department of Defense medical care	.9	1.8	2.8	4.2	8.4	8.5	9.5	
Maternal and child health programs	.3	.4	.6	.9	1.2	1.2	1.4	
Public health activities	.8	1.4	3.2	7.3	11.8	12.5	13.7	
Veterans medical care	1.1	1.8	3.5	5.9	8.7	9.0	9.9	
Medical vocational rehabilitation	.1	.1	.2	.2	.3	.4	.4	
State and local hospitals	2.4	3.3	5.2	5.8	7.3	7.4	8.1	
Other[d]	.3	.8	1.9	3.0	5.3	5.6	6.6	
Medical research	1.3	1.8	3.1	5.1	7.1	7.6	8.2	
Medical facilities construction	.7	1.1	2.0	2.5	2.6	2.5	2.6	
B. Percentage Distribution								
Total expenditures	100.0	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Private	74.1	63.0	57.5	57.6	58.2	58.5	58.6	57.5
Public	25.9	37.0	42.5	42.4	41.8	41.5	41.4	42.5
Federal	13.3	23.6	27.9	28.6	29.4	29.1	28.9	32.6
State-local	12.6	13.4	14.6	13.8	12.4	12.3	12.5	9.9
C. Per Capita								
Total expenditures	$ 206	$ 349	$ 591	$ 1,055	$ 1,696	$ 1,827	$ 1,987	$ 5,551
Private	152	220	340	608	987	1,069	1,164	3,192
Public	54	129	251	447	708	757	824	2,359
Federal	27	82	165	302	498	532	575	1,810
State-local	27	47	86	145	210	225	249	549
D. As a Percent of GNP								
Total expenditures	5.9%	7.4%	8.3%	9.1%	10.5%	10.7%	11.1%	15.0%
Private	4.4	4.7	4.8	5.2	6.1	6.3	6.5	8.7
Public	1.5	2.7	3.5	3.9	4.4	4.4	4.6	6.3

[a] Covers insurance benefits and amount retained by insurance companies for expenses, additions to reserves, and profits.
[b] Includes medical benefits paid under law by private insurance carriers and self-insurers.
[c] After 1965, primarily Medicare.
[d] Expenditurers for Alcohol, Drug Abuse, and Mental Health Administration; Indian Health Service; school health and other programs.
[e] Projection.
Source: Department of Health and Human Services, Health Care Financing Administration; and Tax Foundation computations.

(HEALTH COSTS from page 4)
inflation adjustments. However, Part B costs — primarily physicians' services — have increased eightfold since 1975. Three-quarters of Part B spending comes from the Federal Treasury. Under current law, the other 25 percent must come from monthly premiums withheld from beneficiaries' Social Security checks. With Part B spending rising at nearly 17 percent annually, two negative outcomes result: (1) Sharp increases in the Part B premium — from $110 per year in 1980 to $335 in 1989, not including a mandatory $48 extra in 1989 to help finance the new Medicare Catastrophic Act; (2) Rising Part B costs contribute directly to the federal budget deficit. The House Ways and Means Committee estimates that in 1989 Part B will bring in $9.6 billion in premiums, but drain $32.7 billion from the federal treasury. Even with the administration's savings proposals, Medicare outlays are projected to increase from $94.9 billion in FY1990 to $143.3 billion in FY1994. This sharp increase significantly exceeds general inflation and the growth in the beneficiary population. Unfortunately, this still does not satisfy the Federal government's desire to increase Medicare outlays.

Part B costs — primarily physicians' services — have increased eightfold since 1975.

The Medicare Catastrophic Coverage Act (MCCA) signed into law on July 1, 1988, represents the largest expansion of the Medicare program in its 24-year history. The benefits contained in the act, estimated to cost about $31 billion between 1988 and 1993, are to be paid for by those eligible for the program whether or not they have private supplemental insurance coverage. Payment is made in the form of (1) increased Part B monthly premium rates (also called the flat premium) and (2) increased income taxation of Medicare-eligible individuals called the "supplemental premium." The flat and supplemental premiums would finance the program's catastrophic and drug benefits at the rate of 37 and 63 percent respectively.

Medicare alone has become the largest purchaser of health-care services in this country.

Many tax analysts consider the new supplemental premium to be a poorly disguised progressive tax increase since the act will boost the amount the nation's higher income senior citizens owe the Internal Revenue Service by as much as $1,600 per couple in 1989 and up to to $2,100 in 1993. Poorer seniors will pay as little as $96 a year per couple. Higher-income Medicare beneficiaries are required to pay a 15 percent surcharge on their Federal tax in 1989, rising to 28 percent in 1993. The surcharge is imposed on recipients with incomes high enough to require the payment of Federal income taxes of more than $150 — representing about 41 percent of all couples.

Medicare outlays are projected to increase from $94.9 billion in FY1990 to $143.3 billion in FY1994. This sharp increase significantly exceeds general inflation and the growth in the beneficiary population.

Medicare and Medicaid ... , enacted by Congress in 1965, now account for 28 percent of the total health care bill for all Americans.

Strong opposition to MCCA's surcharge financing provision and its estimated excess reserve have forced Congress to examine options that range from modifying the financing, delaying, or even scrapping the Catastrophic program entirely. The latest Congressional Budget Office estimates indicate that the program's estimated trust fund surplus would not be as large as anticipated earlier this year because of increases in estimated outlays. Historic health program statistics have clearly taught the lesson that health cost outlays inevitably far exceed original projections.

Historic health program statistics have clearly taught the lesson that health cost outlays inevitably far exceed original projections.

Once again this year Congress is merely toying with ways to control soaring health costs, emphasizing a modification of the way Medicare pays doctors, including setting annual overall spending targets for physicians' services. Unless serious long-term cost control action is taken to reduce the explosive growth in health care expenses, Americans will be forced to absorb a rapidly growing health care bill in the years ahead, measured both for individuals and government. Unfortunately, dozens of factors will continue to put upward pressure on health costs. These include the aging of the population, increasing life expectancy, sharp inflation in medical care prices, increasing numbers of treatable acute and chronic illnesses, advances in medical technology, expanding drug abuse treatment, and the increasing numbers of AIDS cases.

The accompanying table and chart provide additional details.

Tax Features

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Facts and Figures on Government Finance To Appear in Print and Diskette Format from Johns Hopkins University Press

The complexity of the U.S. economy is accurately and comprehensively depicted in the Tax Foundation's new 1990 edition of *Facts and Figures on Government Finance*, soon to be released by Johns Hopkins University Press. Every aspect of federal, state, and local finance is presented in tables that sum up the economic activity of governmental units, then examine in detail their taxation, expenditures, debt, and other relevant subjects.

New this year is the availability of all 283 tables on spreadsheets for personal computers. All the difficulties associated with purchasing raw data are avoided with this product. Just open up each table with your own spreadsheet software, either Lotus (for IBM and compatible) or Excel (for Apple Macintosh). *Facts and Figures* on diskette constitutes a superior database for economic research.

Published regularly since 1941, *Facts and Figures* combines data from hundreds of sources, including official government documents and private sources, many of them inaccessible or out of print. *Facts and Figures* furnishes the statistical information necessary to any meaningful debate on issues in public finance.

Some 1990 highlights:

■ Total government spending per person was up 132 percent from $3,373 in 1978 to $7,873 in 1988. The federal government spent $4,877 per person, state government $1,610, and local government $1,350.

■ Total government tax revenues per person were up 114 percent from $2,392 in 1977 to $5,126 in 1987. The federal government collected $3,383 in tax revenue per person, state government $1,090, and local government $653.

■ The 1988 Tax Index for all taxes was at 665.7 (1967 = 100). The biggest tax increase as measured by the tax index has occurred in social insurance contributions at 992.8.

■ Federal, state, and local debt reached $13,910 per capita in 1988. Federal debt alone reached $10,637 per person.

■ Of the 23 nations belonging to the Organisation for Economic Cooperation and Development (OECD), the U.S. ranked 20th in tax revenues as a percentage of GDP in 1986 with 28.9 percent. At the high end were Sweden (53.5 percent), and Denmark (50.6 percent). At the low end were Japan (28 percent) and Turkey at 16.1 percent of GDP.

■ In 1988 there were 89.5 million households, with each household averaging 2.66 persons.

■ In 1987, 17.8 percent of the U.S. population was 25-34 years of age, numbering 43.5 million. By the year 2030, 21.2 percent of the population will be 65 and older, numbering 64.6 million.

■ Connecticut had the highest per capita personal income in 1988 at $22,761 — the lowest was Mississippi at $12,291.

■ Of the 49 largest cities in 1987, Washington, D.C., had the highest per capita general expenditures at $5,331 — the lowest was El Paso at $368.

Mark Your Calendars

TAX FOUNDATION'S 41ST NATIONAL CONFERENCE AND ANNUAL DINNER

Wednesday, November 29, 1989

THE HALLORAN HOUSE NEW YORK, NY

Tax Foundation
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TAX FOUNDATION'S VOL. 33, NO. 6 NOVEMBER 1989

TAX·FEATURES

Tax Foundation Celebrates with CSE Foundation in Washington; Bentsen and Roderick Featured at Annual Dinner in New York

Front Burner

by Bob Packwood
U.S. Senator, Oregon

Sequester May Be Best Medicine For Broken Budget

While somewhat overshadowed by the battle over reducing the capital gains tax burden, it may turn out that the most significant event in this year's budget debate is sequestration — Gramm-Rudman's automatic spending control procedure. Because Congress was unable to reduce the deficit below the $110 billion trigger level, the President issued a sequester order on October 16, reducing the projected 1990 deficit to $100 billion as required by law.

With capital gains temporarily slipping out of the limelight, the sequester has become the focus of partisan debate. Each side accuses the other of being responsible for "deep and arbitrary" budget cuts. Some legislators say we should do whatever it takes to cancel the sequester, even if it means higher taxes. While a sequester is certainly not the ideal way to resolve this year's budget dispute, there are reasons to believe that the fiscal discipline of a sequester is the medicine we need to cure the budget process.

For all its drawbacks, a sequester is real deficit reduction. Instead of budget gimmicks, accounting tricks, phony cuts, and "revenue enhancements," a sequester would reduce spending levels by a fixed percentage in eligible spending programs. In other words, unlike most deficit reduction packages, sequestration would actually reduce the deficit.

(See SEQUESTER on page 2)

Ed. Note: Readers will notice that we have moved the Front Burner up front and changed it to a guest editorial format. TF President Wayne Gable will address readers in a new column as Tax Features *expands and improves. We encourage responses from others in the fiscal policy arena.*

Tax Foundation's friends and supporters gathered at the Mayflower Hotel in Washington November 1 to celebrate the foundation's continuation under the aegis of the Citizens for a Sound Economy Foundation.

After remarks by President Wayne Gable and Co-Chairmen James Q. Riordan and James C. Miller III, several distinguished guests came to the podium. Senator John McCain said of the Tax Foundation, "Without your expertise and knowledge, I don't think we'd do our jobs half as well as we do." Congressman Bill Archer added, "I'm excited for the future of this partnership of Citizens for a Sound Economy Foundation and the Tax Foundation, and I welcome your input in the years ahead." Congressmen Charles Stenholm, Ed Jenkins and Chris Cox also spoke highly of the two organizations.

Conversation focused on the upcoming annual conference in New York City. Scheduled for November 29 at the Halloran House, the conference will start at 1:00 p.m. Kendyl Monroe of Sullivan & Cromwell will chair the first panel on "Revenue Estimating: Evolving Toward Conflict or Consensus?" Speakers will include Gail Fosler from The Conference Board, Kathleen O'Connell of the Congressional Budget Office, Bernard Schmitt from the Joint Committee on Taxation, and John Wilkins from Treasury.

David Milton, retired, formerly of Shell Oil, will lead the afternoon's second panel on the topic: "Is International Taxation Becoming Backdoor Protectionism?" The panelists: William Modahl of Digital Equipment, Phillip Morrison from the Department of the Treasury, and Alan Reynolds of Polyconomics, Inc.

At the annual dinner that evening, the Tax Foundation will confer two Distinguished Service Awards. Recognized for outstanding public sector contributions will be the current Senate Finance Committee Chairman, The Honorable Lloyd Bentsen. At the same time, David Roderick, Retired Chairman and Chief Executive Officer, USX Corporation, will be honored for his private sector contributions.

Hon. Lloyd Bentsen

David Roderick

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Tax Foundation Principles of Taxation

Ed. Note: The Tax Foundation believes it is important to set forth an explicit and consistent set of principles to guide policy discussion. First printed in Federal Tax Policy Memo *last June, we reprint them here to emphasize that they guide our editorial decisions.*

The first five principles focus on tax certainty and taxpayers' ability to comply. Principles six through nine relate to tax policy and economic efficiency, both domestic and international, and principle ten applies one through nine to the whole federal system.

1) A good tax system requires informed taxpayers. It should be clear to the taxpayer who and what is being taxed and how tax legislation is enacted.

2) The tax system should be as simple as possible, easy to understand, and easy to comply with. Compliance expense is a cost to society, and complicated taxation undermines voluntary compliance.

3) Stability is important. The tax law should not change continually. Regulations should be issued promptly after legislation is enacted but frequent change makes this impossible.

4) Changes in the tax law should not be retroactive. Taxpayers should be able to rely with confidence on the law as it exists when they enter a transaction.

5) Tax legislation should be based on sound legislative procedures and careful analysis. There should be open hearings with full opportunity to comment on legislative and regulatory proposals. Revenue estimates should be fully explained.

6) The primary purpose of taxes is to raise needed revenue, not to micromanage the economy with subsidies and penalties. The tax system should aim for neutrality in economic decision making and minimize distortions of the free market. The tax system should not favor consumption over savings and investment (or vice versa).

7) It makes a difference how large a share of GNP is taken by the government in taxes because the taxpaying private sector generates the wealth that determines our standard of living. It makes a difference how we define the tax base because we burden the activities included in the tax base.

8) Taxes should be broadly based and rates of tax should be moderate at all points.

9) As we live in a global marketplace, the U.S. tax system must be competitive with those of other industrialized nations. The U.S. tax system should not impede the free and fair flow of goods, services and capital. It should not penalize imports, exports, U.S. investment abroad, or foreign investment in the U.S.

10) State taxes are an important factor in our federal system. The same general policies that apply to federal taxes should also apply to state taxes. Federal and state tax systems should be harmonized to the extent possible.

(SEQUESTER from page 1)

Yes, a sequester would be bitter medicine. According to current estimates, a sequester would reduce 1990 spending levels for eligible non-defense programs by 5.3 percent and spending levels in defense by 4.3 percent. In terms of the overall budget, a sequester would limit 1990 spending to $1.174 trillion, an increase of only 2.7 percent over 1989 levels.

Many programs would receive no increase in their budgets whatsoever. In a town where regular spending increases are thought of as a Constitutional right, not receiving an increase is equated with having your budget cut. Some programs would actually receive less money in 1990 than they got in 1989. Defense spending, for instance, would actually decline compared to the previous year.

Perhaps the greatest objection to a sequester will result from how certain politically popular programs are affected. Reductions in proposed spending levels for drug enforcement, AIDS research, air traffic control, and military manpower will doubtlessly generate concern among policymakers. Fortunately, however, the Gramm-Rudman law provides legislators and the president opportunities to adjust a sequester. As such, if we can avoid excessive partisanship, we can increase spending levels in high-priority areas so long as we are willing to reduce spending in less important parts of the budget.

Notwithstanding the drawbacks of a sequester, we should not overlook the benefits. Assuming the economy maintains its strength, we will bring the deficit down to $100 billion, the lowest level since 1981 and less than half the level it was as recently as 1986. Perhaps more importantly, a sequester this year will dramatically assist future deficit reduction efforts since it would lower the baseline growth of federal spending. For instance, a $16 billion sequester this year would save taxpayers $22 billion next year and $128.5 billion in total savings over the next five years.

The future savings of a sequester are important because Gramm-Rudman requires that the budget be balanced by 1993. Budget and accounting gimmicks will not do the trick. Both the Senate- and House-passed deficit reduction bills yield little if any long-term savings. A sequester may not produce all the savings needed to reach the $64 billion deficit target for fiscal year 1991, but it will bring us close enough to make any discussion of economically destructive tax increases unnecessary.

The President has rightfully stated that he would be unwilling to repeal the sequester unless Congress was willing to come up with a comparable amount of real savings. Perhaps Congress will pass legislation fulfilling the President's requirements. Should that fail to happen, however, a full-year sequestration would be the preferable outcome.

While a sequester would signal a failure of the budget process, we should hesitate before rushing to somehow nullify the procedure. The authority already exists to make needed adjustments to protect vital programs. Because real deficit reduction is so important, however, it may be time to grit our teeth and let the bulk of the sequester stand.

"Soaking the Rich" No Solution to Government Revenue Shortfalls

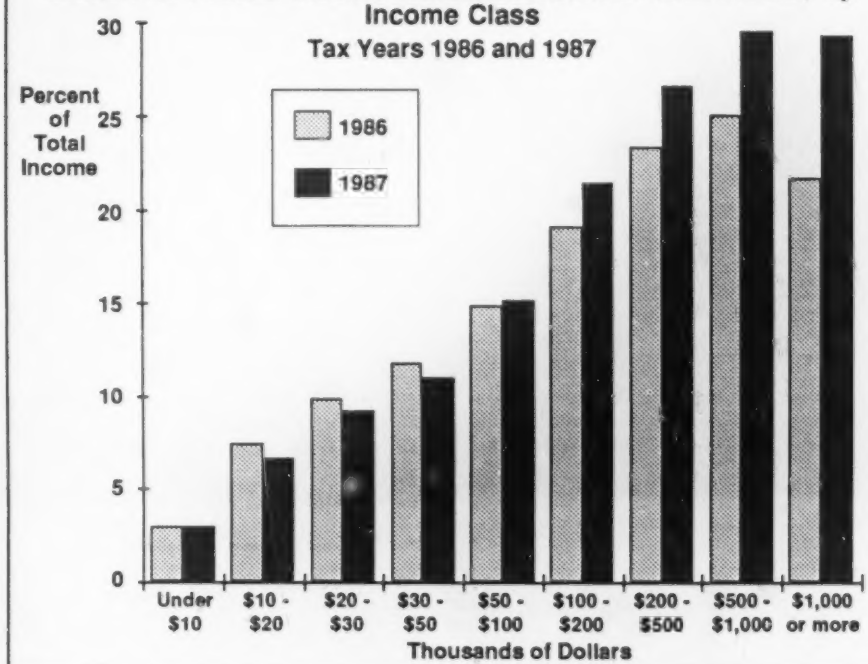
When lawmakers face politically painful revenue decisions, some of them cling to the fond hope that higher income taxes on the wealthy will solve all their problems. They fervently believe that the additional revenue could erase the budget deficit and fund more programs. Alas, if the solution were that easy, it would have been implemented long ago.

Exhibit A. Additional Number of Days the Federal Government Could Run By Taxing Top-Income Brackets at 100 Percent
Tax Year 1987

Adjusted Gross Income Class	Number of Returns	Percent of all Returns	Adjusted Gross Income ($Bil)	Taxable Income ($Bil)	Income Tax Paid ($Bil)	Additional Revenues If Taxed at 100% ($Bil)	Number of Days Federal Government Could Run*
$1 Million or more	36,299	0.03%	$ 87.2	$ 75.5	$ 25.5	$ 50.0	17.1 Days
$500 Thousand or more	113,390	0.11%	$ 139.1	$ 119.8	$ 40.8	$ 79.0	27.1 Days
$200 Thousand or more	545,177	0.51%	$ 263.1	$ 221.3	$ 99.5	$ 121.8	41.7 Days

* 1988 total federal outlays equaled $1,064.0 billion or $2.92 billion per day.
Source: Tax Foundation computations based on Statistics of Income, Internal Revenue Service, U.S. Department of the Treasury.

Exhibit B. Federal Income Tax as a Percent of Total Income by Income Class
Tax Years 1986 and 1987



Tax Year	$0 to $10	$10 to $20	$20 to $30	$30 to $50	$50 to $100	$100 to $200	$200 to $500	$500 to $1,000	$1,000 or More
	Income Class (In thousands of dollars)								
	Tax as a Percent of Total Income								
1986	2.9	7.5	9.9	11.8	14.9	19.2	23.4	25.1	21.7
1987	2.9	6.7	9.3	11.0	15.2	21.4	26.6	29.5	29.3
	Change from 1986 to 1987								
'86 to '87	-	-0.8	-0.6	-0.8	+0.3	+2.2	+3.2	+4.4	+7.6

* Based on Internal Revenue Service standardized income concept and actual tax returns for 1986 and 1987.

The Tax Foundation's ongoing research into tax collections at various income brackets continues to show this "soak the rich" tactic to be a false hope. Exhibit A at left illustrates how much additional tax revenue could be generated at the higher end of the income scale by assuming the most extreme example of taxation — total confiscation of all taxable income — a 100 percent tax rate.

At the top of the income scale, those with a million dollars or more in annual income, there are simply not enough taxpayers to generate a significant increase in revenue. These top earners numbered 36,299 according to 1987 individual income tax data (latest available) and represented just 0.03 percent of all taxpayers. Their adjusted gross income (AGI) totaled $87.2 billion with a taxable income of $75.5 billion, and they paid $25.5 billion in income tax for an average effective tax rate of 29.3 percent on AGI. If the federal government had simply confiscated all of this group's taxable income, Uncle Sam would have collected an extra $50 billion — enough to run the government for 17 days at 1988 outlay levels.

Two and a half weeks goes by quickly, so the government could reach even deeper into the top brackets by appropriating 100 percent of all taxable income from the $500,000-and-over group. This confiscation

(See SOAKING THE RICH on page 4)

Tax Features

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(SOAKING THE RICH from page 3)

could theoretically have netted an additional $79 billion, sufficient revenue to pay its bills for 27 days, but even four free weeks won't put Uncle Sam's accounts in the black.

Taking it a step further, commandeering all the taxable income of $200,000-and-above earners could have brought in $121.8 billion from 545,000 taxpayers, enough to run the federal government for one month and 11 days. While this tactic is now generating more money, it is also moving down from the very rich to families who are merely well-off.

To generate substantial new revenue, the government would have to reach far down the income scale, a move that would undoubtedly raise stiff political opposition. To impose higher tax rates on just the top ten percent of taxpayers, for example, would affect returns starting at $54,700 (including joint returns), an income level which certainly does not qualify for "fat cat" status.

TRA'86 No Boon to Top Earners

The often heard argument that the Tax Reform Act of 1986 provided upper-income individuals with a bountiful tax cut at the expense of the middle- and lower-income classes quickly fades when examining the actual 1987 tax return data. Total individual income tax receipts reached $371 billion in 1987, a modest 1 percent or $4 billion increase over 1986 collections. Despite this increase, the average amount of income tax paid per taxpayer actually declined from $4,374 to $4,280. Individuals earning $50,000 or more paid $24 billion more in income tax in 1987, while the under-$50,000 income group experienced a tax reduction of $20 billion. Since the two-earner median family earned $44,536 in 1987, the "middle-class" clearly benefited from this $20 billion tax reduction.

Exhibit B on page 3 uses tax return data to detail the changes in the income tax distribution by income class between 1986 and 1987. Total income tax as a percentage of income remained unchanged at 13.2 percent. However, income classes under $50,000 showed a lower effective tax rate for 1987 and those classes over $50,000 showed a higher effective tax rate. In fact, the greatest increase was for the $1-million-or-more income class where the effective tax rate increased from 21.7 to 29.3 percent.

It is easy to overlook the fact that upper-income groups are now absorbing more of the federal income tax burden because these facts rarely surface in the tax burden debate. Some policymakers will no doubt continue to offer "soaking the rich" as a panacea. In reality, any significant tax increases would end up soaking the average American as well.

Fiscal Notebook

Conferences

- The National Taxpayers Union will sponsor the first National Taxpayers Conference. Speeches and workshops on legislative strategies to limit taxes. December 9-10 in St. Louis. Call 202-543-1300.
- The Tax Executives Institute's conference, EC 1992: A Single Market, will cover tax and trade implications of European unification. December 10-12 in Washington, D.C. Call 202-638-5601.
- The International Tax Institute will hold a conference in New York City on the CFC Netting Rule. Speaker: Charles Brezak. Call 212-407-3398.

Publications

- The Institute for Research on the Economics of Taxation has released *U.S. Foreign Tax Policy and the Global Economy: New Directions for the 1990s.* A compilation of papers on policy barriers to competition abroad. $5.95. Call 202-347-9570.
- The Urban Institute recently released *Chartbook on the Medically Uninsured.* Who among the medically uninsured would be affected by legislation requiring employers to provide group health insurance? 8/89, 20 pp., $7.95. Call 301-459-3366.
- The American Council for Capital Formation has issued a brief special report entitled *The Importance of Capital Gains Tax Rates to Individual and Corporate Investors.* 9/89, 2 pp., free. Call 202-293-5811.

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TAX FOUNDATION'S VOL. 33, NO. 7 DECEMBER 1989

TAX·FEATURES

Bentsen Pushes Savings Incentives as Key to 1990 Tax Package; Capital Gains Tax Cut a Possibility

Front Burner

by Wayne Gable
President, Tax Foundation

The Burden of Corporate Tax Compliance

When major tax reform surfaced in the early 1980s, one of its primary objectives was simplification. Unfortunately, that intention dropped by the wayside when Congress finally produced the mammoth Tax Reform Act of 1986. What taxpayers are left with is the most complex tax code ever and the onerous burden of tax compliance.

According to data derived from a study prepared for the Internal Revenue Service, the equivalent of one percent of the total U.S. civilian workforce is devoted to determining just the corporate income tax liability. This tremendous amount of manpower dedicated to tax compliance comes at a huge cost. For example, in 1983 it cost the U.S. economy $35 billion to raise $37 billion in corporate income taxes. This is an outrageous cost contrasted with the revenue collected. One percent of the nation's gross national product was consumed by the cost of complying with the corporate income tax. Clearly this effort does not represent the most efficient use of the nation's economic resources.

The study prepared by the A.D. Little Company for the IRS indicates that 2.7 billion hours were spent in reporting the various tax liabilities of business. This is the equivalent of a year's work from 1,350,000 persons and is more manpower than our total U.S. military establishment. Individuals devote the time of an additional 797,000 persons for a year to comply with the personal income tax.

To get a clearer perspective on just what these numbers mean, it is useful to note what percent of our national effort goes toward more

(See FRONT BURNER on page 4)

"We must do a better job of encouraging savings and investment in this country," Senator Lloyd Bentsen told the Tax Foundation's 52nd annual dinner in New York November 29th. "My goal will be to develop a bipartisan package of cost-effective savings and investment incentives. Will capital gains be on the table?" he asked. "No doubt."

The assembled crowd of corporate executives applauded this sign that the Senate Finance Committee Chairman would not exclude a capital gains tax cut from the tax bill he will offer in the next congress. Senator Bentsen's speech followed the Tax Foundation's presentation to him of a Distinguished Service Award for contributions in the public sector and to David Roderick, director and former chairman and chief executive officer of USX for contributions in the private sector.

The Texas Democrat did make it clear, however, that he sees an enhanced IRA proposal as a critical part of any tax package the Senate Finance Committee puts together. He ascribed an improvement in Canada's savings rate to broadened IRA measures and pointed to new studies in the U.S. that show an increase in savings of three dollars for every one dollar of tax revenue lost through IRA deductions. "I believe that the figures would be even better for the IRA proposal I put forth this year, which allows a 50 percent rather than a 100 percent deduction," Senator Bentsen continued. "In short, the IRA is a retirement plan that never should have been retired."

From left, the recipients of Tax Foundation's Distinguished Service Awards: David M. Roderick, director and former chairman and chief executive officer, USX Corporation, for contributions in the private sector; and The Honorable Lloyd Bentsen, senior senator from Texas, for contributions in the public sector.

He also tempered his endorsement of a capital gains tax cut with cautionary remarks about the revenue neutrality of such a measure. "The biggest problem for capital gains relief is the one

(See BENTSEN on page 2)

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Front Burner
PAGE 3:
Annual Conference

(BENTSEN from page 1)

that proponents of a capital gains tax cut refused to face this year: How do you pay for it? . . . We would have to answer the virtually unanimous verdict of economists that after that first year such a cut drains the treasury."

"My goal will be to develop a bipartisan package of cost-effective savings and investment incentives. Will capital gains be on the table? No doubt."

The price the U.S. will pay if it does not stimulate savings and investment is an eroded economy, according to Senator Bentsen, and he already sees symptoms of that erosion:

- Excessive debt: With the national debt tripling during the decade of the 80s, the interest payments alone last year took the personal taxes of all taxpayers west of the Mississippi.
- High interest rates: We now have a 10.5 percent prime rate compared to 9 percent in Germany and 4.875 percent in Japan.
- Low productivity: It has averaged barely 1 percent, or less than half the rate in Germany and Japan.

"Why can't we do better?" Bentsen asked. "One key is capital accumulation. Having enough money to invest is what has sparked the U.S. standard of living — and helped spur the success of western democracy. Now we don't have enough. And the main reason is our emergence as the world's leading debtor economy."

The Honorable Lloyd Bentsen addresses the Tax Foundation Annual Dinner.

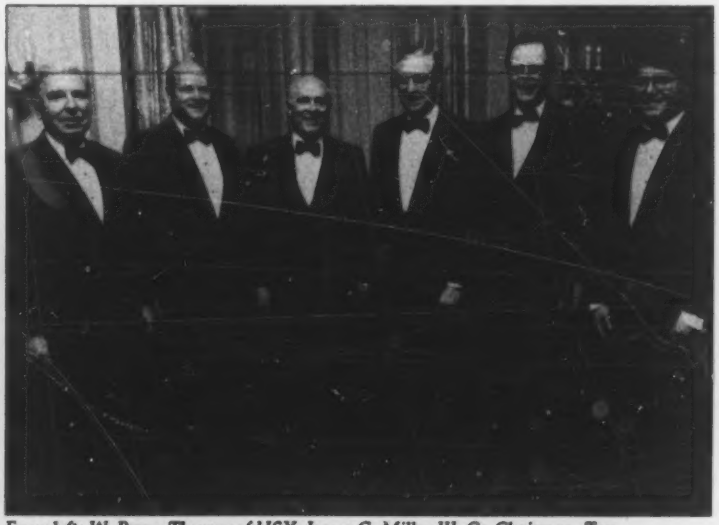
He dismissed the notion that the national debt is just money we owe to ourselves and therefore not a serious problem. While emphasizing that foreign money invested in the U.S. brings benefits to the nation's economy, he pointed to our high interest rate as the primary reason for heavy foreign investment here. Expanding on this theme, he gave examples of different kinds of foreign investment.

"Foreign investment [could be] a source of strength. In the 19th century English investment helped build much of the railroad that first connected the east and west coasts. But today that foreign investment is not being used to finance America's future. It's being used to buy Rockefeller Center. . . . and to finance consumption."

"I believe that the figures would be even better for the IRA proposal I put forth this year, which allows a 50 percent rather than a 100 percent deduction. . . . In short, the IRA is a retirement plan that never should have been retired."

Senator Bentsen closed his remarks with an appeal to all Americans to make whatever sacrifices are necessary to save and invest more. Moreover, he challenged legislators to exercise strong leadership, to take the often unpopular actions that will encourage Americans to save and invest, making the country economically stronger.

Senator Lloyd Bentsen talks at the head table with Tax Foundation President, Wayne Cable.



From left: W. Bruce Thomas of USX; James C. Miller III, Co-Chairman, Tax Foundation; Distinguished Service Award winners David M. Roderick of USX, and Sen. Lloyd Bentsen; James Q. Riordan, Co-Chairman, Tax Foundation; and Wayne Gable, President, Tax Foundation.

Tax Features

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Tax Foundation's 42 Annual Conference Addresses Revenue Estimation and International Taxation

The Tax Foundation held its 41st Annual Conference in New York City the afternoon of November 29. Corporate executives, professors and students of economics and public finance, and members of the business press heard presentations from experts in the fields of revenue estimation and international taxation.

"Revenue Estimating: Evolving Toward Conflict or Consensus?" served as the theme of the first panel discussion. The subject was addressed by Kathleen O'Connell, Deputy Assistant Director for Tax Analysis at the Congressional Budget Office; Bernard Schmitt, Associate Chief of Staff, Revenue Analysis, at the Joint Committee on Taxation; John Wilkins, Senior Economic Advisor, Department of the Treasury; and Gail Fosler, Chief Economist at The Conference Board.

Kendyl K. Monroe, Partner, Sullivan & Cromwell, moderated the panel and highlighted the importance of revenue estimating in his introduction. "There is a strong view, in the private sector at least, that much of modern tax legislation has been driven by revenue estimates as distinguished from tax policy. That does open the question of just what tax policy is . . . and gets into some fundamental discussions about tax legislation altogether."

At left, David R. Milton, retired, formerly of Shell Oil, moderated the international taxation panel, here speaking with two of the panelists, William Modahl (center) and Alan Reynolds at right.

Kathleen O'Connell was first to address the assembled corporate tax executives. She clearly stated her view that consensus prevails among professional estimators to a much greater degree than observers and pundits seem to think. Even the words controversy and conflict are terms that she sees as being borrowed from politics and having little place in the technical field of "econometric modeling and fiscalization of payment patterns."

Ms. O'Connell ascribes the appearance of conflict to three factors: So many groups are generating revenue estimates, or what they call revenue estimates, that "you can't tell the players without a scorecard." Second, some estimators, though not CBO, are guarded about the sources of their estimates, and this confidentiality has created the impression of a mysterious process at work. Third, users of revenue estimates discuss them out of context and without reference to their real purpose.

Bernard Schmitt of the Joint Committee on Taxation followed Ms. O'Connell with remarks on many aspects of revenue estimation. He also traced the events that have made estimators more visible on the fiscal policy scene.

"Going back to the Budget Act of 1974," the gears were set in motion. The "budget deficits of the 1980s . . . and the change in the indexing system" speeded the process, according to Mr. Schmitt. Gramm-Rudman contributed to the increased importance of revenue estimates but even more so the Tax Reform Act of 1986, "which, in fact, dictated absolute neutrality within tax provisions and tax proposals, . . . Anybody that wants to spend some money has to come up with a way to pay for it."

John Wilkins of Treasury concentrated his remarks on the issue of static vs. dynamic estimates, and asserted that contrary to the frequent criticism that official revenue estimates are not sufficiently dynamic, they do in fact take adequate account of behavioral changes in the economy that result from proposed tax provisions.

Revenue estimating panel from left: Bernard Schmitt of the Joint Committee on Taxation, Kathleen O'Connell of the Congressional Budget Office, Gail Fosler from The Conference Board, and John Wilkins from the Department of the Treasury.

The panel's presentations were completed with remarks by Gail Fosler of The Conference Board. One of the points she made was that regarding some new targets of taxation, pools of public data that estimators have traditionally relied on do not exist. She cited LBO activity, the tax contained in the reconciliation bill on ozone-depleting chemicals, and the alternative minimum tax as areas where revenue

Phillip Morrison, International Tax Counsel, Department of the Treasury

(See CONFERENCE on page 4)

(FRONT BURNER from page 1)

productive pursuits.

Three percent of the nation's employment is devoted to agricultural production, but we devote over one-third as much time to filling out corporate tax reports as we do to feeding ourselves. Total annual housing production costs about five percent of GNP whereas managing the corporate income tax costs fully a fifth as much.

What is lacking in our tax system is the efficiency that comes with simplicity. The tax system should be as simple as possible, easy to understand, and easy to comply with. The complexity of our current tax code continues to impose a tremendous cost on society.

The staggering increase in the complexity and the administrative burden of our tax code must stop. During the past decade alone, over fourteen major tax bills have been enacted. A tax code that changes continually destroys the stability needed for business investment and planning. Simplicity is critical in fostering efficiency for both the tax collector and taxpayer. Compliance expense is a cost to society that should not be ignored. Without serious reform towards simplicity, compliance will become a heavier burden on our economy than the taxes themselves.

(CONFERENCE from page 3)

estimation relies on difficult judgment calls. She called on the private sector and on non-profit groups like the Tax Foundation to provide more of the basic research needed for accurate revenue estimation.

David Milton, retired, formerly Vice President and Chief Tax Counsel of Shell Oil, led the afternoon's second panel on the topic: "Is International Taxation Becoming Backdoor Protectionism?" The three panelists were William Modahl, Director of Tax Affairs, Digital Equipment; Phillip Morrison, International Tax Counsel, Department of the Treasury; and Alan Reynolds, Chief Economist, Polyconomics, Inc.

Mr. Modahl opened by saying that although there are protectionist trends in international tax policy, he concentrated his criticism on the tax code provisions that hinder U.S. investment abroad. He focused particularly on the Tax Reform Act of 1986 and urged that, "Today we need to complete the process of tax reform with a major overhaul of corporate taxation in the direction of a border adjustable system that eliminates both domestic double taxation of capital and international double taxation of earnings."

Phillip Morrison, just recently installed as International Tax Counsel at Treasury, looked at a variety of international tax issues. He finds "Capital export neutrality and capital import neutrality [to be] increasingly irrelevant in the increasingly globalized economy." Mr. Morrison hypothesized that a harmonized international tax system would tax no income twice but allow none to escape untaxed. If other nations adopted our tax system, the areas where such double- or non-taxation occurred should be studied for possible unilateral change by the United States.

Alan Reynolds of Polyconomics, Inc. finished the second panel discussion by ridiculing those in the U.S. who oppose the globalization of the U.S. economy and try to keep American investment in the U.S. by creating tax incentives for domestic investment. "There has always been a group in Congress that wanted to isolate the U.S. economy from foreign competitive pressure — goods, assets, anything. They want to isolate us in a way that successful economies such as Albania and North Korea have always done."

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TAX FOUNDATION'S VOL. 34, NO. 1 JANUARY 1990

TAX·FEATURES

Increasing Corporate Tax Burden Finishes Decade on the Upswing

Front Burner

by Alan Reynolds
Chief Economist
Polyconomics, Inc.

Tear Down the Protectionist Wall

Some members of Congress want to build the tax and regulatory equivalent of a new Berlin Wall around the United States. This Berlin Wall is designed to keep foreigners out, or in the case of the Burke-Hartke bill, to keep American investment in.

A second group of legislators, often overlapping with the first, is eager to protect the managers of companies susceptible to takeovers or buyouts, whether domestic or foreign, that might threaten to enrich U.S. stockholders.

Both of these anticompetitive interests find common ground in thinly disguised efforts to discourage foreign investment by tinkering with the tax code. Recent attempts to sneak several protectionist proposals into the budget reconciliation process are revealing.

One of them was an attempt to tax the capital gains on sales of stock in U.S. companies by foreigners who own more than ten percent of such stock. With an estimated tax revenue of only $5 million, not billion, revenue obviously was not the point. There was a hidden agenda at work, but it wasn't too well hidden. The *Financial Times* caught it quickly with a headline that said "U.S. Plan Attacks Foreign Buyers."

Foreign retaliation against a proposal like that would be almost guaranteed. The vicious cycle of retaliation would snuff out capital gains revenue windfalls everywhere, as the efficient

(See FRONT BURNER on page 2)

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial responses are encouraged.

With federal deficits hovering around $150 billion, the government will continue its drive for more revenues. Corporations are often targeted because they are said to be undertaxed. Despite statistical evidence to the contrary, this recurring theme seems to have a life of its own and always resurfaces when more revenues are required for increased spending. In fact, corporations carry a heavy tax burden and provide a large and growing percentage of the total tax revenue collected by the federal government.

Recent Corporate Tax History

In 1981, Congress enacted a significant corporate tax cut under the Economic Recovery Tax Act of 1981 (ERTA). If it had been allowed to take effect fully, it would have substantially reduced overall corporate income tax liabilities in the 1980s. Instead, there were major contravening tax bills starting with the Tax Equity and Fiscal Responsibility Act (TEFRA) in 1982 and the Deficit Reduction Act (DEFRA) in 1984. Outside of the Tax Reform Act of 1986, the major drive behind tax legislation after 1981 was purely and simply to increase tax revenues. The Tax

Outside of the Tax Reform Act of 1986, the major drive behind tax legislation after 1981 was purely and simply to increase tax revenues.

Reform Act of 1986 obliterated the capital recovery and business tax relief of 1981 and effectively piled on significant net increases in corporate tax liabilities after 1986. More recently, further increases in corporate income taxes have occurred as a result of the Omnibus Budget Reconciliation Act of 1987 and the Continuing Resolution for 1988. Table I on page 2 compares the effect of major enacted legislation in the 1981-1988 period on individual and corporate income taxes currently and projected through 1992. Individuals' taxes are markedly lower than they would have been without the legislation, but the corporate sector is

(See CORPORATE TAX BURDEN on page 2)

This article is taken from the Tax Foundation's recent Special Report on the corporate tax burden which is available for $2.50 plus $1 p/h.

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Facts & Figures
Conference Proceedings

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another story entirely.

Starting in 1984, corporate income tax collections have been steadily increasing, leaping from a low of $37 billion in 1983 to a record $94.5 billion in 1988. The growth in corporate tax revenue has coincided with better business conditions in recent years and, of course, the implementation of the 1982, 1984, and 1986 tax bills which increased corporate tax burdens. The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 repealed more than half of the benefits provided by ERTA to corporations in 1981. The Deficit Reduction Act (DEFRA) of 1984 further reduced corporate depreciation allowances. In fact, the Tax Reform Act (TRA) of 1986, which was supposed to be "revenue neutral," will raise an additional $24 billion in corporate tax revenues this year alone. Nearly everything provided in the so-called "corporate giveaway" of 1981 was taken back before the benefits could be fully realized.

Table I

Impact of Major Tax Legislation, Enacted 1981-1988[a], on Individual and Corporate Income Tax Receipts

Fiscal Years 1988-1992

($Billions)

Income Tax	1988	1989	1990	1991	1992
Individual	$ -201.4	$ -237.6	$ -259.4	$ -288.4	$ -326.9
Corporate	+24.0	+27.2	+33.7	+42.6	+43.7

[a] Budget effect revenue estimates are prepared by the Office of Management and Budget. They measure only the direct effect of tax legislative changes on receipts with "feedback" effect limited to the overall income forecast and its impact on receipts by major source.

Source: Budget of the U.S. Government, FY 1990

Corporate Tax Burden

A good indicator of the corporate tax burden is a comparison of corporate taxes with corporate profits. When looking at the corporate taxes, federal corporate income taxes are only part of the picture. Table II on page 3 illustrates the overall burden of federal corporate income tax when it is combined with the rapidly increasing state/local corporate income taxes and corporate payroll taxes. Such payments can be partially deducted for federal corporate income tax purposes, but they are a substantial and growing burden nonetheless.

For comparability, corporate tax accruals net of Federal Reserve earnings are used instead of actual tax receipts. Given today's full acceleration of corporate tax payments, the accruals figures are close to tax payments.

While Federal corporate income tax revenues have risen 52 percent

(See CORPORATE TAX BURDEN on page 4)

(FRONT BURNER from page 1)

flow of capital around the world is constricted.

Another amazingly provincial proposal would have disallowed deductions for research performed outside the United States by U.S. foreign affiliates. If that were enacted, foreign parent companies would simply license their research, charging royalties to any surviving U.S. affiliates. Obviously, that would reduce U.S. corporate profits and corporate income tax receipts.

. . . a fifth of West German manufacturing is foreign-owned. They don't complain about that. In our case, it is five percent, but we worry.

Such proposals are making it abundantly clear that foreigners wishing to do business in the United States are not welcome. What conceivable problem does foreign investment cause that requires such risky bullying of countries with which we have tax treaties?

Let's examine some basic facts about foreign ownership: Foreigners hold about one percent of U.S. farm land, six percent of U.S. stock, thirteen percent of corporate bonds, and fifteen percent of government debt. U.S. direct investment abroad still exceeds foreign investment here.

Japan, against whom most of the anxiety seems to be focused, is only the third largest investor in the United States, way behind Britain and the Netherlands. Half of Canadian manufacturing and a fifth of West German manufacturing is foreign-owned. They don't complain about that. In our case, it is five percent, but we worry. Foreign ownership accounts for a larger share of all major countries' stocks and bonds, but that is just smart diversification. Pension funds and mutual funds offer the ability to invest in various countries because it minimizes risk.

How could the ownership of a few companies by foreign investors mean they really control anything? They are not going to control our destiny. They cannot force Americans to buy their products. They cannot force us to work for them.

America must quell its fear of foreign investment because the free flow of funds across borders is vital to the nation's economic health. Attempts by legislators to wall off the U.S. from the world economy will alienate other nations, cause stagnation in our economy, and ultimately diminish our own tax revenue.

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Table II

Federal and State/Local Corporate Income Taxes and Corporate Payroll Taxes

National Income Account Series

1970-1989

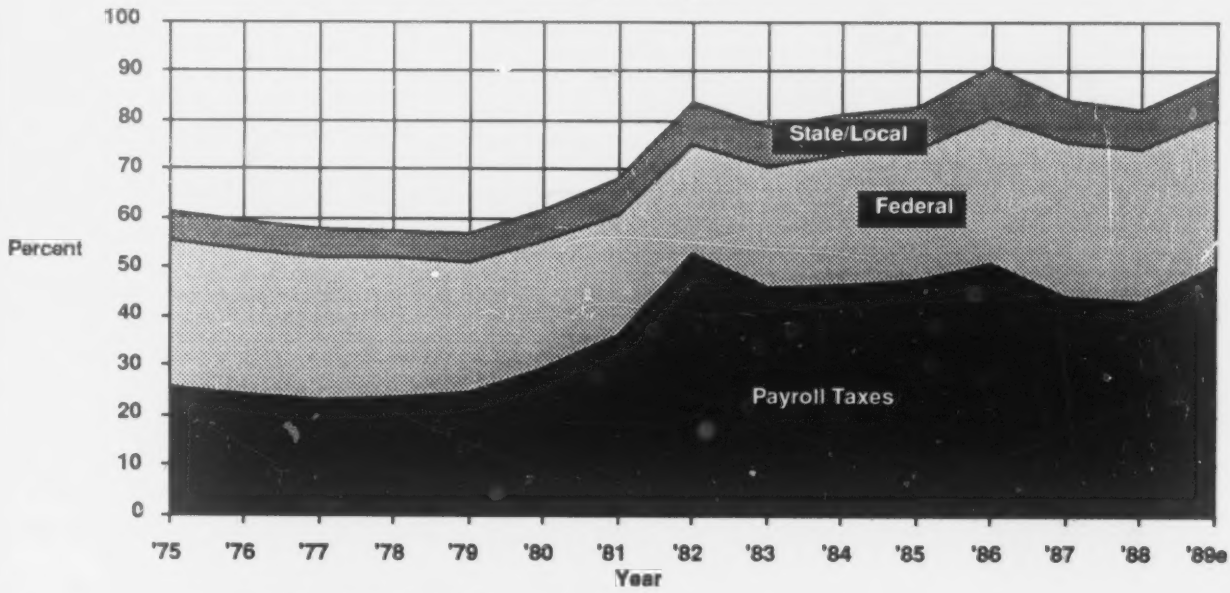
(In Billions of Dollars)

Year	A Corporate Profits	B Federal Corporate Income Tax Accruals[a]	C Effective Rate of Federal Tax (B/A)	D State/Local Corporate Income Tax Accruals	E Effective Rate of Federal and State/Local Tax (B+D/A)	F Corporate Payroll Taxes[b]	G Inc. & Payroll Taxes Relative to Corp. Profits (B+D+F/A)
1970[c]	$ 72.4	$ 27.1	37.4 %	$ 3.7	42.5 %	-	-
1971	84.0	30.1	35.8	4.3	41.0	-	-
1972	98.1	33.4	34.0	5.3	39.4	$ 22.7	62.6 %
1973	122.7	39.0	31.8	6.0	36.7	29.5	60.7
1974	133.2	39.5	29.7	6.7	34.7	33.2	59.6
1975	129.1	38.2	29.6	7.3	35.2	33.6	61.3
1976	164.3	48.7	29.6	9.6	35.5	39.8	59.7
1977	194.2	55.7	28.7	11.4	34.6	45.4	57.9
1978	225.8	64.4	28.5	12.1	33.9	53.7	57.7
1979	247.6	65.1	26.3	13.6	31.8	62.2	56.9
1980	225.2	58.6	26.0	14.5	32.5	66.6	62.0
1981	212.0	51.7	24.4	15.4	31.7	77.6	68.3
1982	154.0	33.8	21.9	14.0	31.0	81.7	84.1
1983	192.8	47.1	24.4	15.9	32.7	89.0	78.8
1984	223.3	59.1	26.5	18.7	34.8	104.4	81.6
1985	224.3	58.5	26.1	20.2	35.1	107.6	83.1
1986	221.6	66.0	29.8	22.5	39.9	113.6	91.2
1987	266.7	83.3	31.2	23.7	40.1	118.1	84.4
1988	306.8	94.1	30.7	26.5	39.3	132.9	82.6
1989[d]	295.3	89.0	30.1	25.1	38.6	150.0	89.4

[a] Net of Federal Reserve Earnings.
[b] Includes corporate employer share of OASDHI, state unemployment insurance tax, federal unemployment tax, railroad unemployment insurance and retirement, and workers' compensation.
[c] Includes some effect from Vietnam period surcharge.
[d] Estimates based on first three quarters of 1989.
Sources: Economic Reports of the President, various years; published and unpublished statistics of the Department of Commerce, Bureau of Economic Analysis, and Tax Foundation Computations.

Corporate Income and Payroll Taxes Relative to Corporate Profits

1975 – 1989



Source: Tax Foundation computations (see table above).

(CORPORATE TAX BURDEN from page 2)
since 1980, state/local corporate income tax revenues have increased 73 percent for the decade and in 1989

. . . the Tax Reform Act (TRA) of 1986, which was supposed to be "revenue neutral," will raise an additional $24 billion in corporate tax revenues this year alone.

represented 28 percent of the federal tax take. The combined federal, state and local corporate income tax take has risen steadily since 1982, far surpassing the level of the early 1970s.

The largest element of the business tax burden has become the payroll sector, particularly federal social security and hospital insurance. Furthermore, state unemployment insurance and other social insurance funds have intensified the tax burden. These taxes are not imposed on net income, and some economists argue that even the employer share of payroll taxes is borne by employees who receive lower rates of compensation and benefits than they would in the absence of these taxes. However, where labor is relatively scarce and/or subject to rigidities in compensation, that burden may have been absorbed by the employer. The corporate share of payroll taxes has far outstripped corporate income taxes and currently costs about $150 billion.

Over the past decade, the combined increases in federal income taxes and the state/local and payroll taxes have caused a tremendous increase in the overall corporate tax burden. Compared to profits, the burden increased 32.5 percentage points from 56.9 percent in 1979 to 89.4 percent by 1989. Throughout the 1970s, this rate averaged only about 60 percent. The 1989 overall corporate tax burden, representing a whopping 89 percent of corporate profits, is huge by historic comparison. Federal deficit pressure and the sharp growth trend in state and payroll taxes can easily push this burden even higher.

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Tax Features

Average Family Faces Tax Bill of $12,938 in 1990

President Bush has released the Administration's budget to an uproar of criticism and commentary from interest groups all along the political spectrum, but few people are asking the most basic, down-to-earth question: How much will the government tax the average American family and how will that money be spent? According to Tax Foundation economists, a moderate-income family — two workers earning $45,000 with two dependent children — faces a tax bill of $12,938 for 1990. That covers the family's direct and indirect federal taxes. Add to this its $718 "share" of the federal deficit and the average family will contribute $13,656 to support the estimated $1.23 trillion Uncle Sam plans to spend in the new budget.

"Interest payment on the federal debt, . . . at $173 billion, costs a family 13 and 1/2 cents of its tax dollar, or a whopping $1,751 per year."

Assuming that the $12,938 tax bill is allocated to cover the typical family's entire share of federal spending, the following expenditures stand out:

- Income security tops the list at $418.5 billion. This comprises primarily Social Security, federal retirement, and unemployment, extracting 33 cents for each $1 the American family sends to Washington, for a per-family total of $4,237.
- National defense will cost $303.3 billion — or 24 cents out of each tax dollar. For the moderate-income family, this amounts to $3,070 per year.
- Interest payment on the federal debt ranks third at $173 billion, costing a family 13 and 1/2 cents of its tax dollar, or a whopping $1,751 per year.

See Median Family on page 2

FRONT BURNER

Let's Bring Glasnost to Revenue Estimates

Sen. Robert W. Kasten, Jr.

Thanks to the Freedom of Information Act, most of our government's actions are open to public scrutiny. But one major exception remains — the making of U.S. tax law.

The Congressional tax-writing process remains shrouded in secrecy. The fate of proposed tax changes — like cutting the capital gains tax or expanding savings incentives — are often decided behind closed doors by the accountants and economists who make revenue estimates.

For the past 50 years, the revenue estimates prepared by the Joint Committee on Taxation and the Treasury Department played only a minor role in the making of Federal tax policy; the estimates merely provided legislators with helpful reference points for proposed tax changes. But the rising budget deficits and tighter Gramm-Rudman budget procedures have heightened the role of these estimates to the point that they often dictate policy, to the detriment of other important goals like fairness, efficiency and economic growth.

To be sure, the revenue-neutrality test imposed by the Gramm-Rudman process is an important fiscal restraint, and we ought to stick to it. That's why it is essential for Congress to have accurate estimates for proposed tax legislation.

But in some of the most important tax policy debates of the last decade and a half, the official estimates were often misleading, incomplete and incorrect — leading Congress

See Kasten on page 5

Robert W. Kasten, Jr., a Republican, is the senior U.S. Senator from Wisconsin.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

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Median Family from page 1

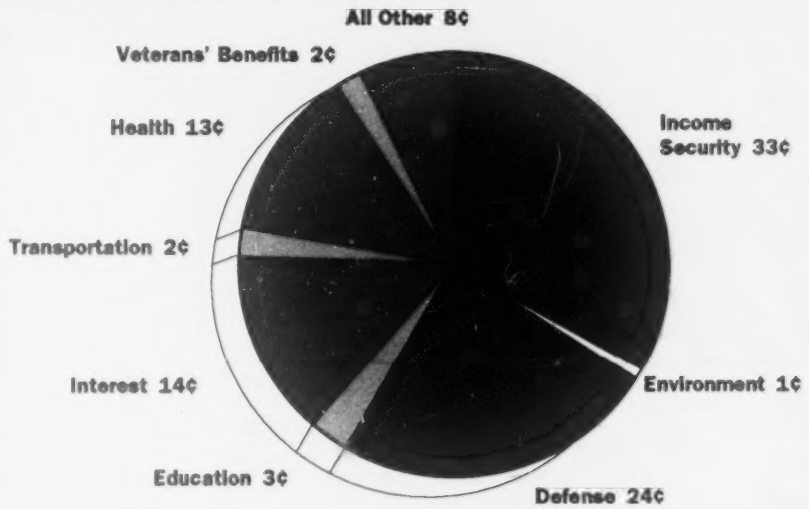
■ Health outlays, mainly Medicare and Medicaid, will take 13 cents of each tax dollar. The typical family will send Uncle Sam $1,643 in 1990 to pay for the $162.3 billion national health bill.

"The typical family will send Uncle Sam $1,643 in 1990 to pay for the $162.3 billion national health bill."

These four items alone will claim 83 percent of all federal spending and will cost the moderate-income family $10,701, or 83 cents of each tax dollar. Compared to these big four items, spending on all other programs is relatively small. With the remaining 17 cents, Uncle Sam will spend 3 cents of the family's tax dollar on education, and less than 3 cents each on environment, transportation, science, and administration of justice.

"Uncle Sam will spend less than 3 cents per dollar each on environment, transportation, science, and administration of justice."

How the Federal Government Will Spend the Average Family's Tax Dollar in 1990

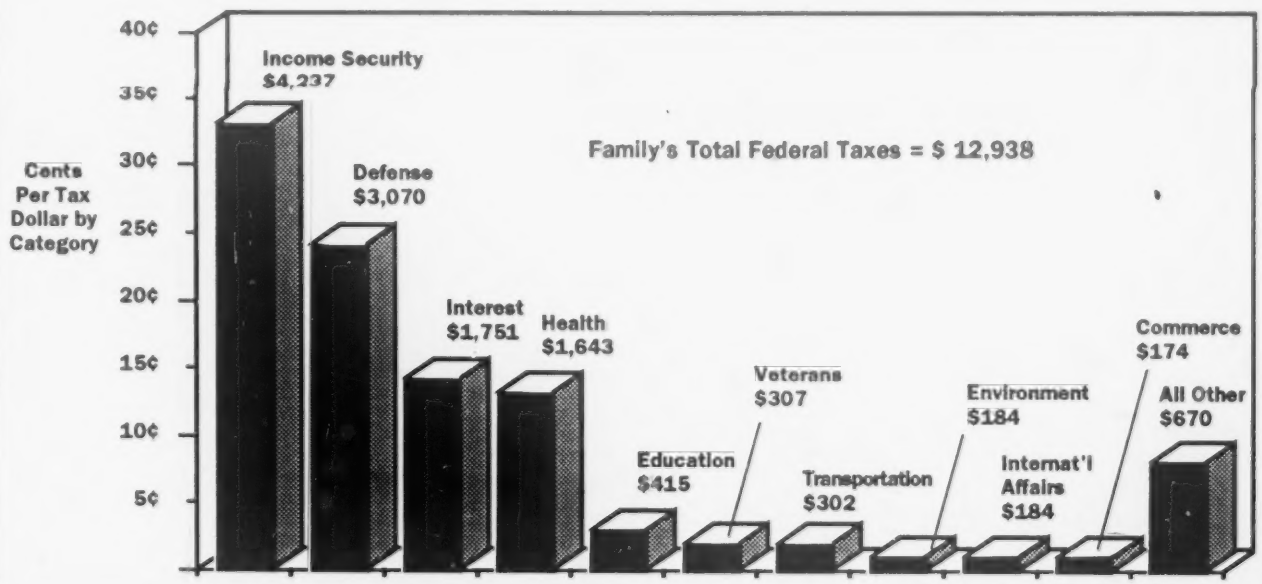


The Family Tax Bill

Direct federal taxes — individual income and personal Social Security taxes — will cost this family $8,219 in 1990. However, direct levies do not explain the whole tax burden, accounting for only about three-fifths of what the government takes in. To these must be added such indirect taxes as the employer's share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor, and

See Median Family on page 6

How the Federal Government Will Spend the Average U.S. Family's Taxes in 1990



Highlights of the President's FY1991 Budget

By James C. Miller III

The release of President Bush's 1991 budget proposal has been met with predictable, inside-the-beltway partisan sniping and canned "sound bites." The budget would meet the Gramm-Rudman-Hollings deficit target of $64 billion for fiscal year 1991 without substantial new taxes or increases in tax rates. Some major points about President Bush's budget are highlighted below:

If enacted (and if the Administration's economic assumptions hold true), receipts to the Federal government would rise by $96.7 billion ($1,073.5 billion to $1,170.2 billion) — $82.8 billion from inflation, economic growth, and tax code changes already enacted and $13.9 billion in proposed policy changes. This represents a 9.0 percent increase — or a 5.0 percent increase after adjusting for inflation.

Government outlays would rise by $36 billion ($1,197.2 billion to $1,233.3 billion), or 3.0 percent — 1.0 percent less than inflation. This would constitute the first reduction in real spending since 1987 (which, in turn, was the first in two decades).

"The president's . . . three-point savings initiative . . . will undoubtedly be the first step in a long process of partisan wrangling that surrounds the saving issue."

Offsetting collections are revenues that show up as "negative outlays" and thus mask the total amount of government revenue and spending. President Bush's budget submission decreases offsetting collections by $7.4 billion (from $154.0 billion to $146.6 billion), primarily because of a substantial reduction in premiums paid by savings and loan institutions. If offsetting collections are added to the revenue and outlay figures, total revenues would go up by 7.3 percent, and outlays would go up 2.1 percent.

The president's budget also includes a three-point savings initiative. This initiative reduces capital gains tax rates based on the length of time an asset is held, and provides a maximum exclusion of 30 percent on gains from investments held for more that three years. It allows use of Individual Retirement Accounts (IRAs) for first-time home purchases and creates Family Savings Accounts, which allow households with incomes below $120,000 to deposit up to $5,000 per year in seven-year, tax free accounts. This will undoubtedly be the first step in a long process of partisan wrangling that surrounds the saving issue.

Revenue-raising proposals likely to attract attention include extending Social Security coverage to state and local employees not participating in public employee retirement programs, permanently extending the telephone excise tax, and increasing airport and airway fees. The budget also includes new or expanded "user fees" for the Securities and Exchange Commission, the Internal Revenue Service, mine reclamation, the Commodity Futures Trading Commission, the Federal Emergency Management Agency, and the Corps of Engineers.

The budget includes a series of tax credit proposals. The president proposes to expand and make permanent research and experimentation tax credits, provide tax relief for the oil and gas industry, permanently extend the health insurance deduction for the self-employed, extend the low-income housing tax credit, establish a new tax credit for low-income families with young children, restore and double the adoption tax credit, and establish urban enterprise zones.

Spending initiatives emphasized in the Bush budget include increases in budget authority of $3.3 billion for space and other science programs, $4.5 billion for research and development programs, $500 million for Head Start, $1.1 billion for drug programs, and $2 billion for environmental programs.

President Bush also unveiled the "Social Security Integrity and Debt Reduction Fund." The plan would mandate that after 1993, Social Security trust fund surpluses be gradually used to pay down the national debt. The purpose of the plan is to increase the national savings rate and lower government interest payments. By 1996, 100 percent of the surpluses would be committed to the debt repayment fund. The Social Security Trust Funds reduce the 1991 deficit by $80 billion.

As expected, this budget has been controversial and criticized severely.

"Critics point to the Administration's proposals to "cut" Medicare. Actually, these proposals would only slow the growth in Medicare spending."

On the revenue side, some are disappointed that there is no major tax increase. On the other hand, many have criticized the Administration's proposed tax changes. The cut in the capital gains rate has generated charges of "tax cut for the rich," and critics have maintained that other provisions constitute "ducks," even though they don't waddle excessively. A third major criticism has been the treatment of the Social Security surplus.

On the outlay side, critics have focused on the absence of a "peace dividend." Rather than decrease, as many had predicted, total outlays for defense would go up — from $296.3 billion $303.3 billion. They have also pointed to the Administration's proposals to "cut" Medicare. Actually, these proposals would only slow the growth in Medicare spending (which would go up from $96.9 billion to $98.6 billion). And, there are controversies over priorities: whether the Administration has proposed enough for education, the environment, drug enforcement, AIDS research, and the like, and why it has proposed cuts in energy, commerce and housing credit, and some community and regional development programs.

See Bush Budget on page 4

James C. Miller III is a former Director of the Office of Management and Budget and currently serves as Co-Chairman of the Tax Foundation.

Bush Budget from page 3

Since this year is an election year, and Members of Congress have returned to Washington anticipating a peace dividend to spend, the going will be very rough for the President's budget. However, the alternatives (tax increases, spending cuts, drift in the deficit) appear politically unpalatable as well, and given the President's extraordinary popularity, the prospects appear reasonably good for a budget outcome that does not stray too far from the Administration's proposal.

On the outlay side, critics have focused on the absence of a "peace dividend."

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PRESIDENT'S MESSAGE

Bringing the Budget Home to the American Family

Wayne Gable

When President Bush released his 1991 budget in January, the attendant media noise nearly drowned out the average taxpayer's weary question, "How much is it going to cost me this year?" The Tax Foundation heard the cry of the American taxpayer and calculated the dollar impact of the new budget on the typical American family. (See page 1.)

Tax Foundation economists have computed not only the total the average family will pay, but the portion of that dollar amount to be spent on each category of government expenditure. This breakdown reveals that four categories of government spending — income security, defense, interest on the debt, and health — gobble up over four-fifths of our tax money.

This is the kind of analysis that the Tax Foundation will always strive to do. It brings the Budget of the United States— a 1,500-page document weighing over 5 pounds — down to size and supplies the raw information that citizens must have to answer such questions as: How much of the federal tax dollar goes toward education? What is the average family's contribution to income security? How much per family for defense?

We at the Tax Foundation are dedicated to bringing comprehensible information to the American people and have found that the media, who often have to rely on organizations with an ax to grind, are eager to use Tax Foundation data. On the morning after the budget's release, *ABC World News This Morning's* Stephen Aug broadcast the story which serves as this issue's lead. More often, we explain issues in government finance to reporters, supplying them with historical tables which serve as background for their own stories. But we do not shun this low key, behind-the-scenes role because our reputation as a reliable source of unbiased data was built and strengthened over the years through just this sort of informal educational activity.

The Tax Foundation's stated mission has always been to provide objective research and public education on the taxing and spending activities of federal, state and local governments. In the pursuit of this goal, we will strip away partisanship and rhetoric in favor of facts and clearcut analysis. In a nutshell, we will help the American people to know what is happening to their money.

NOTABLE

- **In 1970, spending on mandatory health programs totaled $9 billion, or 5% of total outlays. Now at $233 billion, it is over 15% of total outlays.**
- **Total mandatory programs were 34% of the budget in 1970. They will exceed 50% in 1991.**
- **Over $1 trillion in outstanding home mortgages have been guaranteed by the government.**
- **At the end of 1989, the face amount of federally assisted credit and insurance outstanding was $5.8 trillion, 2 and 1/2 times the national debt.**
- **The ratio of the federal debt to GNP rose from 27% in 1980 to a peak of 43% in 1988 and declined slightly in 1989.**

Tax Features

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Kasten from page 1

to enact misguided tax increases and reject much-needed tax cuts.

Case in point: Capital gains. In 1978, Treasury and the JCT claimed that cutting the top rate on capital gains from 50 to 28 percent would lose $2 billion in annual revenue. Over the next three years after the tax cut, the stock market boomed and revenues jumped $3.6 billion. The estimators had clearly failed to account for the behavioral response of investors who realized more gains due to the tax cut. (Similarly, the JCT estimates of the 1986 Tax Reform Act failed to predict a $20 billion revenue windfall in 1986 as investors sold assets late in the year to beat the capital gains tax increase in 1987.)

Case in point: 10 percent withholding on dividends and interest. The JCT claimed that the 10 percent withholding provision in the 1982 tax increase bill would raise $4.2 billion in 1983. Sen. Lloyd Bentsen (D-TX, now Chairman of the Senate Finance Committee) argued that withholding would "create an administrative nightmare and impose a substantial new burden and red tape on the private sector — and quite likely yield substantially less tax revenue than projected." Bentsen called the JCT's numbers "suspect" — charging that "the net revenue effect of this hastily drawn provision may be zero for all everyone knows."

Case in point: Tax Reform Act of 1986. Supply-siders argued that the JCT estimates should recognize the incentive effects of tax rate cuts (reduced avoidance, evasion, and consumption of untaxed fringe benefits) which mitigate the potential loss of tax revenues. The huge static loss estimates from the personal tax rate cuts resulted in a heavier tax burden on corporations ($140 billion) — thus stifling savings and investment. As a result, tax reform came dangerously close to tipping the economy into a recession, all for the sake of an unnecessary tax hike.

Case in point: Section 89. According to the JCT, the Section 89 uniform-benefits tax law repealed last year would raise $154 million in 1990. In fact, American businesses would have spent over $4 billion in deductible costs to comply with Section 89 — resulting in less tax revenue for the government. According to a private sector analysis based on a survey of businesses representing 19 percent of the workforce, Section 89 would have reduced revenues by $800 million in 1990.

In all these cases, the principle of "garbage in — garbage out" applies. Inaccurate statistics can lead to real legislative setbacks, and to an unwise and counterproductive national tax policy. In the Senate, "revenue-losing" tax provisions require 60 out of 100 votes before they can be considered — or else someone's taxes have to be raised.

I think it's high time that we open up the revenue estimating process to public scrutiny — and require JCT to measure the dynamic impact of tax changes on the real economy. In 1988, I introduced a bill called the Tax Policy Information Act to improve the revenue estimating process. The bill would require public disclosure of JCT's assumptions, data, and methodology used to arrive at revenue estimates.

"The fate of proposed tax changes — like cutting the capital gains tax or expanding savings incentives — are often decided behind closed doors by the accountants and economists who make revenue estimates."

The JCT estimators defend the secrecy of the process by claiming that public disclosure would bias the estimates. I believe that the opposite is true: Full disclosure could only improve the process, by making it responsive to the needs of the real economy. It would facilitate exchange between the JCT and outside economists, which would result in improved techniques, data collection and revenue modeling — all of which would lead to more accurate estimates.

The Congressional Budget Office (CBO) is an excellent example of what happens when you open up the process to the light of day. Their models and methods are well-documented and open to constructive criticism, and the result is integrity and realism in the estimating process.

Another necessary reform is to require dynamic revenue analysis as well as the prevalent — and highly unrealistic — static methods. A dynamic estimate predicts how a tax change will play out in the real world, as opposed to under the green eyeshades. For example: If a $10,000 tax were imposed on red cars, static estimates would multiply $10,000 by the number of red cars produced and predict large revenue gains. A dynamic revenue estimate would predict that most people would buy cars of another color — and thus predict very low revenue gains.

The JCT often chooses to ignore economic reality — and tax policy suffers as a result. In response to one query during the recent capital gains debate, JCT said that a 100 percent tax on incomes over $200,000 would raise between $200 and $300 million a year forever. In the bizarre Disneyland of static revenue estimates, men and women will continue to work in order to send all of their income over $200,000 to the government. Moreover, static assume that these men and women will not shelter or underreport their income.

Clearly, this kind of static estimate is highly unrealistic. In contrast, dynamic estimates take human behavior and economic reality into account. Even the JCT has moved in the direction of quasi-dynamic estimates in the case of capital gains. But it persists in predicting that cutting the capital gains rate to 15 percent would result in a long-term revenue loss — despite the predictable revenue-increasing effects of such a cut (like higher asset values and increased stock of capital).

While it's true that dynamic analysis is difficult, it is better to be imprecisely correct than precisely wrong.

And this is why the issue of revenue estimation is so important: Bad revenue estimates can create policies that wreck the economy. If we were to listen to the demagogues on capital gains — who all rely on static estimates — we would have no choice but to squelch this essential tax cut, thus yielding the competitive advantage irretrievably to the Japanese and others who know the unhappy truth about static estimates.

It's essential that we build economic policy on the solid ground of realistic estimates. To prevent abuse of the disclosure and dynamic-estimate

See Kasten on page 6

Median Family from page 2

tobacco; and miscellaneous levies. These will take another $4,719 from the average family's income.

Direct and indirect federal taxes will claim 28.8 percent of this family's annual income, but even that does not tell the whole story. All told, current federal taxes and borrowing will add up to nearly 30 percent of the moderate-income family's earnings.

See table below for further details.

Kasten from page 5

requirements, we should only apply them to tax changes that result in revenue changes of $100 million or more in a single year; but apply them we must. Revenue estimation isn't a parlor game — it's a matter of life and death for the millions of workers and business people who rely on a healthy economy. Let's implement these changes soon, before we get sidetracked into some awful economic folly we will all live to regret.

How the Federal Government Will Spend a Family's Tax Dollar in 1990[a]

Function	Family's Share: Amount	Family's Share: Percent of Total	Spending (Billions)
Income Security[b]	$ 4,237	32.75%	$ 418.5
National Defense	3,070	23.73	303.3
Net Interest	1,751	13.54	173.0
Health[c]	1,643	12.70	162.3
Education, Training, Employment, Social Services	415	3.21	41.0
Veterans' Benefits and Services	307	2.37	30.3
Transportation	302	2.33	29.8
Environment and Natural Resources	184	1.42	18.2
International Affairs	184	1.42	18.2
Commerce and Housing Credit	174	1.35	17.2
General Science, Space and Technology	168	1.30	16.6
Agriculture	151	1.17	14.9
Administration of Justice	128	0.99	12.6
General Government	114	0.88	11.3
Community and Regional Development	79	0.61	7.8
Energy	30	0.23	3.0
Total[d]	$ 12,938	100.00%	$ 1,233.3

[a] This example uses a two-earner family earning $45,000 per year with two dependent children.
[b] Primarily social security. Includes federal employee retirement, unemployment compensation, and nutrition assistance. Excludes veteran's income security.
[c] Primarily Medicare and Medicaid. Excludes veteran's health care.
[d] After deducting $44.7 billion in undistributed and offsetting receipts not classified by function.

Source: Tax Foundation computations based on Fiscal Year 1991 U.S. Budget presented January 29, 1990, and 1990 tax laws from U.S. Department of Treasury.

Tax Foundation to Hold Seminar on Tax Treatment of Research and Development

On Thursday, March 22, 1990, the Tax Foundation will host a seminar on R&D tax policy at the Hyatt Regency on Capitol Hill in Washington, DC. Starting at 12:30, an opening address will outline the issue and two panels of experts from government and industry will address the problems. After a closing address, an informal cocktail reception will follow from 5:30 to 7:30. Call Paul Merski for more information at 202-863-5454.

QUOTABLE

"If the Moynihan proposal were to set off a Great Debate that forced the nation to clarify its thinking about the nature of our social security programs, and that brought reality more in line with image, the senator will have made a major contribution to public policy."

Paul W. McCracken, professor emeritus, University of Michigan, and a former chairman of the President's Council of Economic Advisers.

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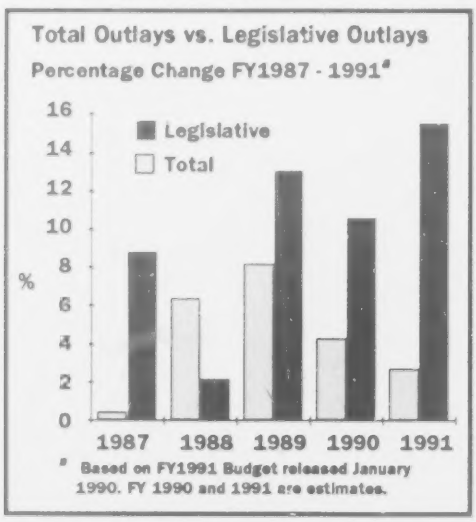
Tax Features

U.S. Congress Carries $2.3 Billion Price Tag in 1990

Up 10.6 Percent Over 1989

Last year's failed Congressional pay raise was slam dunked nationwide with great fanfare, and the slightly less generous one enacted later just went into effect last month. But that raise is a drop in the bucket compared to the $2.3 billion taxpayers will pay to fund the operations of the nation's legislative body during fiscal year 1990.



Overall spending on the legislative branch is estimated to rise $222 million in FY1990, hitting an all-time high of over $2.3 billion. While total federal spending is estimated to increase 4.8 percent this year, legislative branch spending will increase more than twice as fast at 10.6 percent.

The cost of Congress itself, now over $1.1 billion, has risen a whopping 93 percent since 1980 and costs over six times more than it did in 1970. The Senate will run $385.3 million ($3.9 million per Senator), while the House will require $571.1 million ($1.3 million per Representative). Joint activities of the House and Senate will cost an additional $167 million.

Congress also maintains a number of legislative agencies, such as the Congressional

See Cost of Congress on page 4

FRONT BURNER

Insure Social Security with A Tax Cut

Sen. Daniel Patrick Moynihan

On December 29, 1989, I announced, with little fanfare but some ensuing attention, that I would introduce on the first day of the second session a bill to cut Social Security contribution rates and return the system to pay-as-you-go financing.

The bill — which I introduced on January 23, 1990 — would strengthen the Social Security system, restore honesty and integrity to our federal finances, and provide a fair tax cut to 132 million Social Security taxpayers.

The Social Security tax rate increased on January 1 from 6.06 percent for employees and employers each to 6.2 percent — excluding the 1.45 percent rate for Medicare. The bill would repeal this rate increase retroactively, further cut the rate effective January 1, 1991, to 5.1 percent, and schedule future tax rate increases starting in 2012.

This would be a $62 billion tax cut for working people over two years. For a single person or a couple with combined earnings at the Social Security taxable maximum in 1991 (an estimated $54,300), the tax cut savings would be about $600 in that year alone. Savings in future years would be even greater.

At the same time, future Social Security benefits would be even more secure than they are under present law. The legislation would put Social Security on a sound current cost, or pay-as-you-go, financial basis that would keep the system solvent for the next 75 years — or 20 years longer than under the current arrangements.

I do not take this measure lightly, or without awareness of the complexity of the

See Moynihan on page 2

Daniel Patrick Moynihan, a Democrat, is the senior U.S. Senator from New York.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

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matter. To the contrary, at the beginning of last year I made it quite explicit that this option might have to be chosen.

Specifically, the report of the Democratic Commissioners of the National Economic Commission (NEC), issued on March 1, 1989, dealt primarily with the opportunities presented by the existence of large and growing surpluses in the Social Security trust funds. We stated that if the administration and Congress could bring about a balanced operating budget, the Social Security surplus would allow us to retire privately held government debt. This would automatically translate into an increase in national savings — perhaps doubling the current savings rate — which offered a means of insuring a strong productive U.S. economy capable of supporting retirees in the next century. We recommended this.

At the same time, Commissioners Strauss, Gray, Iacocca, Kirkland, Rohatyn and myself were explicit in stating that unless this were done, there would be no defensible reason for continuing the payroll tax at present levels, and that Social Security would have to be returned to pay-as-you-go financing as a matter of simple fairness.

"The bill would strengthen the Social Security system, restore honesty and integrity to our federal finances, and provide a fair tax cut to 132 million Social Security taxpayers."

The General Accounting Office made the same recommendation in their report, *Social Security: The Trust Fund Accumulation, the Economy, and the Federal Budget,* released January 19, 1989. The GAO suggested:

> If the Congress and the President are unable to agree upon and implement a strategy for restoring fiscal balance in the non-Social Security part of the budget, we believe that the Congress should reconsider the pattern of payroll tax increases that is producing the current and projected social security surpluses. To implement this option, it would be appropriate to return the social security program to a pay-as-you-go financing basis once the social security reserves have reached a desirable contingency level of about 100 to 150 per cent of annual outlays.

As we pointed out in our NEC report, and as was made very clear in the GAO study, the operating budget deficit is not declining. It is growing. The deficit for FY 1989 was $204 billion without the Social Security surplus. The Congressional Budget Office baseline projections show the deficit in the operating budget growing to $268 billion in the year 2000. In that same year the Social Security surplus will be $236 billion. A $268 billion deficit financed almost exclusively by the Social Security payroll tax.

This is totally unacceptable. The tax structure of the United States is fast becoming one of the most regressive of any Western nation. The 1980s have witnessed a decline in the progressivity of federal taxes as a whole — income, payroll, and excise taxes combined — despite improvements made in the Tax Reform Act of 1986. The Social Security Administration reports that of those taxpayers who will pay any Social Security tax in 1990, about 74 percent will pay more FICA taxes — including the employer's share — than in income taxes.

The 1983 decision to move the Social Security trust funds to a partially funded basis was a responsible one. But the only justification there can be for running large Social Security surpluses is to use the surpluses to increase national savings — and thereby provide for higher future productivity and income to support the retirement of the baby boom generation. This was the aim, but we have not achieved it; so the time has come to return Social Security to pay-as-you-go financing.

Social Security was financed on a pay-as-you-go basis for decades prior to 1983. Under this financing method, we schedule Social Security tax rates that will produce the revenue needed for about a year's worth of outlays. We have not had a reserve of a year's worth of benefits since 1970, but under this bill we would have such a reserve at the end of 1990, and at the end of 2065, and at the end of every year in between.

Robert J. Myers, who helped create our Social Security system in 1934 and who for 23 years was its chief actuary, has urged a return to pay-as-you-go financing. In testimony of May 1988 before the Senate Finance Subcommittee on Social Security, Myers stated: "I believe that Social Security should be financed on close to a current cost basis. Income should, on the whole, slightly exceed outgo each year, in order to build up a fund which is about equal to one year's outgo — and certainly no more. This should be accomplished by changing the future tax-rate schedule so as to more nearly match the trend of outgo."

We have tailored our proposal to Mr. Myers' specifications. A Social Security tax rate of 5.1 percent starting in 1991 will be sufficient to finance benefits through 2011 while maintaining a reserve of about a year's worth of benefits. In 2012 the tax rate would rise to 5.6 percent. The legislation schedules a tax rate of 6.2 percent (the current rate) for 2015, 7.0 percent for 2020, and 7.7 percent for 2025. The rate would peak at 8.1 percent for 2045 and later years.

"Social Security benefits would be even more secure than they are under present law."

Let me stress that the reserve that would build up under the current law would be exhausted in 2045 in any event, so at that point we would have to go to the same 8.1 percent rate. Also, assuming only modest rates of economic growth between now and 2045, workers at that time will make twice as much in real terms as workers today. Finally, the proposed rise in the rate over the next 55 years is modest compared to the historical rise over the past 55 years. In 1935, the rate was set at 1 percent of the first $3,000 of wages. This has risen, with full public support, to 6.2 percent of the first $51,300 of wages. This is a six-fold increase in the rate over the past 55 years, compared to a 59 percent proposed increase over the next 55 years.

We must end the shameful practice of using Social Security revenues to finance budget deficits. This proposal will restore honesty and integrity to the federal fisc, strengthen the Social Security system, and provide a much-needed tax cut for low and middle-income American workers.

U.S. Should Put Its Own Tax System in Order Before Fretting over EC92 Rules

Alan Lipner and Dan Lundy

The Ways and Means Committee heard testimony in January to explore and address the implications for U.S. business of EC1992 and an open Eastern Europe. We reproduce here a summary of the testimony given by Mr. Lipner and Mr. Lundy, who testified on behalf of the Tax Council, a business-supported tax policy group.

We are concerned that harmonization of direct taxes in the EC may ultimately result in adverse consequences for U.S. multinationals, particularly with regard to the potential for increased withholding taxes on funds flowing out of the Community and the removal of local country investment incentives. However, since the development of a comprehensive direct tax harmonization policy is still at a very early stage, these concerns are largely speculative. Of real, immediate import to U.S. business today are not internal EC tax policies, but U.S. tax rules which raise barriers to U.S. competitiveness in the European Community and to overseas business in general. The Tax Council's submission to the Committee identifies the most troublesome of these rules as well as their single unifying characteristic — a severe competitive disadvantage for U.S. multinationals.

"While tax policies emanating from the European Community and Eastern Europe may ultimately pose competitive problems for U.S. business, the most immediate . . . barriers to U.S. competitiveness in these markets are created by our own tax system."

Particularly significant to U.S. business are the numerous restrictions on the use of the foreign tax credit and the extension of the current U.S. tax net to active business income of foreign subsidiaries. Neither of these features of the U.S. tax system figure prominently in any European country's scheme of taxing the foreign income of its multinationals.

The most problematic of the U.S. tax rules relating to foreign tax credit utilization are:

- the affiliated group method of allocating interest and other expenses;
- the separate company-by-company limitation for dividends from noncontrolled Sec. 902 corporations;
- the separate limitation for high withholding tax interest;
- the effect of overall domestic losses;
- repeal of the Bon Ami rule; and
- limitations on the alternative minimum tax foreign tax credit.

U.S. business will continue to be harmed by the exercise of quasi-global U.S. taxing jurisdiction, specifically in connection with the following U.S. tax rules:

- the repeal of U.S. tax deferral for active banking, financing and insurance income;
- present law limitations on the "same country" exception under subpart F;
- the extraterritorial application of U.S. life insurance concepts under subpart F;
- limitations on deficit utilization under subpart F;
- the passive foreign investment company provisions, particularly as applied to controlled foreign corporations; and
- the commensurate with income standard for measuring royalties on exported intangibles.

In summary, while tax policies emanating from the European Community and Eastern Europe may ultimately pose competitive problems for U.S. business, the most immediate as well as long-term barriers to U.S. competitiveness in these markets are created by our own tax system.

Alan Lipner is senior vice president - corporate tax for American Express; Dan Lundy is senior vice president and director of taxes for ITT.

Ways and Means Committee Explores Foreign Investment

The House Ways and Means Committee held four days of hearings during the last two weeks of January to examine the growing controversy over whether to restrict direct foreign investment coming into the United States or to promote the free flow of capital across borders.

Inbound Investment

According to testimony given by Robert F. Hudson, Jr., chairman of the Florida Bar Tax Section, "U.S. tax policy . . . has resulted in perceived and actual discrimination against foreign direct investment in the United States, with the result of diverting potential foreign direct investment either toward U.S. portfolio investments or away from the United States totally."

Specifically, Hudson feels that the system of U.S. income and estate and gift taxation of foreign investors is unfair and that the tax consequences of investing in the United States have scared off the typical individual or family-based foreign direct investor.

"The U.S. subsidiaries of foreign companies are not, themselves, foreign. . . . They are, for the most part, managed by U.S. citizens and they do not serve foreign political interests."

— James Merle Carter
Organization for Fair Treatment of International Investment

Hudson explained how the Tax Reform Act of 1986 was the "first clear step in favor of portfolio investment and against direct foreign investment in the United States." Many liberalizations given to U.S. citizens, such as a much higher estate tax credit, are not available to foreign persons.

James Merle Carter, secretary of the Organization for Fair Treatment of International Investment, testified in fa-

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vor of treating foreign investors in the United States no differently than U.S. investors. He reminded the committee that, "The U.S. subsidiaries of foreign companies are not, themselves, foreign. . . . They are, for the most part, managed by U.S. citizens and they do not serve foreign political interests."

Carter then addressed the concern that foreign investors have an unfair advantage in the United States. He stated that one of the reasons foreign investors are able to put so much money into the American market is the lower cost of capital abroad. He admitted that this is "an area in which many foreign investors have an advantage." However, Carter insisted that the answer is to make U.S. capital more competitive by changing U.S. tax laws so that they do not "make equity more expensive than debt and tax capital gains at the same rate as profits."

Outbound Investment

Nancy Oliver, director of trade policy for Citizens for a Sound Economy, touched on U.S. tax treatment toward U.S. companies that invest overseas. "The U.S. government taxes at a single rate the worldwide income earned by U.S. companies. As a result, American companies have a harder time competing against foreign companies in countries with a lower corporate tax burden."

"The U.S. government taxes at a single rate the worldwide income earned by U.S. companies. As a result, American companies have a harder time competing against foreign companies in countries with a lower corporate tax burden."

— Nancy Oliver
Citizens for a Sound Economy

She added that even though foreign tax credits were designed to reduce double taxation, "the complexity of the system places a huge compliance burden on U.S. companies and inhibits their overseas investments."

QUOTABLE

"U.S. managers are pretty darn good . . . but captains of industry in the U.S. complain that they can't manage for the long term because they don't have the incentive to do research and development."

— Jerome Kohlberg, Partner, Kohlberg & Co., testifying March 2, 1990, before the Senate Committee on Banking about the bankrupty of Drexel Burnham Lambert

Cost of Congress from page 1

Budget Office, General Accounting Office, and the Architect of the Capitol, each of which has its own budget. These will cost taxpayers $1.2 billion in 1990, 14 percent more than last year.

What does all this money buy? Taxpayers are primarily paying for four things: Congressional leadership, staff and administration; committees and subcommittees; and legislative agency personnel.

"The legislative branch now employs over 37,600 workers. Congress itself has 19,500 on the payroll — 7,400 in the Senate and 12,100 in the House."

The U.S. Office of Personnel Management reports that the legislative branch now employs over 37,600 workers. Congress itself has 19,500 on the payroll — 7,400 in the Senate and 12,100 in the House.

Congress's committee system is comprised of 20 committees and 87 subcommittees in the Senate, employing over 770 professional staff, plus 27 committees and 155 subcommittees in the House, with 1,271 professional staff attached. Adding in the joint committees brings the total to over 50 committees and 250 subcommittees in the congressional bureaucracy, paying a professional staff of over 2,100 people.

While this year's $2.3 billion legislative branch spending represents a 10.6 percent increase, 1991 spending is estimated to increase even faster, rising at a 15.6 percent clip for a cost of $2.68 billion. Overall federal spending for the same year is estimated to increase only 3 percent. See details in table above.

Outlays for the Legislative Branch of the Federal Government by Unit

Selected Fiscal Years 1970-1990[a]

($ Thousands)

Unit	1970	1980	1989	1990
Senate	57,585	183,890	347,030	385,319
House of Representatives	108,279	324,569	549,189	571,112
Joint activities	13,295	73,084	152,675	167,016
Congress, total	179,159	581,543	1,048,894	1,123,447
Architect of the Capitol	18,797	99,496	122,037	195,728
Botanic Garden	620	1,583	2,502	2,680
Congressional Budget Office	-	12,101	17,617	19,019
General Accounting Office	69,857	201,192	334,811	356,703
Government Printing Office	34,141	115,747	70,884	96,593
Library of Congress	49,804	192,740	478,015	493,056
Office of Technology Assessment	-	11,131	17,870	18,354
U.S. Tax Court	2,972	9,703	25,626	29,502
Other	-	13,675	2,065	5,815
Deductions for offsetting receipts	-12,203	-10,926	-26,501	-24,932
Legislative agencies, total	163,988	636,442	1,045,826	1,193,498
Total	$ 343,147	$ 1,217,985	$ 2,094,720	$ 2,316,945

[a] Data for 1990 are estimates from the FY 1991 Budget presented in January 1990.

Source: Office of Management and Budget.

Gwendolyn S. King

The Social Security System: Safe and Sound For the 21st Century

As Commissioner of Social Security, I am heartened by the current debate on the future financing and continued long-term health of the Social Security program. Such discussions give the American people the chance to learn more about a program that is so important to so many.

Today, Social Security is financially sound. In fact, 1990 marks the 50th anniversary of Social Security's paying benefits, on time and in the right amount, to those who depend on them. And over the next four decades, the Social Security trust fund reserves are projected to grow substantially, ensuring that the program can make good on its commitment to pay monthly benefits to future generations of retirees.

The Bush Administration has a solemn commitment to protect and preserve Social Security. We need to assure its continued solvency and build even greater public confidence in the program. However, I have a unique responsibility as Commissioner to ensure that the current discussion on Social Security edifies, and does not confuse or mislead, the public on America's most important and successful social program. Based on much inaccurate information that has been disseminated to the public recently on this issue, I believe it is necessary to set the record straight on what is fact, and what is fiction.

Fiction: Social Security reserves are being used to finance general government operating expenses and, thus, are nothing more than worthless IOUs. They are not being invested for the public's benefit.

Fact: Section 201 of the Social Security Act stipulates that Social Security reserves are to be invested exclusively in interest-bearing U.S. government obligations. The law's creators intended that the public's money should be placed in the safest possible investment, backed by the full faith and credit of the U.S. government.

Because Social Security trust funds are invested in Treasury obligations, the money, after investment, has always been available to the government for its general operating needs.

Social Security dollars do draw interest. The Treasury pays the Social Security Trust Fund substantial interest payments — 9.7 percent in the year ending June 30, 1989.

Fiction: Social Security reserves are sufficiently high, allowing a payroll tax cut and a return to the pay-as-you-go system.

Fact: The 1983 Social Security Rescue Amendments were adopted because of a realization that the pay-as-you-go philosophy left the system vulnerable to the effects of economic downturns. Back-to-back recessions in the late '70's and early '80's moved Social Security dangerously close to fiscal catastrophe. At one point, the contingency reserve contained only 14 percent of the next year's benefit expenditures, necessitating interfund borrowing from the Hospital Insurance Trust Fund.

At the beginning of 1990, the Social Security Trust Fund had accumulated $188 billion. That money represents only nine months' worth of benefit payments. There is general agreement that a contingency of 100-150 percent of the funds needed to pay one year's worth of benefits should accumulate before changes in system financing are even discussed.

Fiction: The Social Security payroll tax is a regressive tax.

Fact: Social Security provides significant protection to surviving spouses and children, as well as to insured workers and their families in the event of disability. In fact, about 40 percent of Social Security benefit payments are in these non-retirement categories.

The Social Security benefit structure is highly progressive. It provides considerably higher benefits for low earners, in relation to their pre-retirement earnings, than for high-income workers. For workers retiring at age 65, Social Security benefits replace approximately 58 percent of earnings, 42 percent for mid-income Americans and 24 percent for high-income earners.

Today, a low-income worker retiring at age 65 will gain back his or her lifetime Social Security tax contributions, plus interest, in about four years. High-income workers will gain their contribution back with interest in about seven years.

Fiction: Currently 74 percent of taxpayers pay more in Social Security payroll tax than they do in federal income tax.

Fact: Only 29 percent of those who pay any Social Security tax pay more to Social Security than they pay in federal income tax.

The frequently-quoted 74 percent figure stems from an illogical comparison, weighing the Social Security tax paid by both employer and employee to the income tax paid by workers alone.

Fiction: A payroll tax cut is a useful tool to force the government to reduce operating budget deficits without endangering the solvency of Social Security.

Fact: A roll-back of Social Security contributions will, in fact, exacerbate the budget deficit by $43 billion in FY 1991 and more in later years. Traditionally, Social Security policy has been shaped and guided solely by the objectives of the Social Security program and the best interests of its beneficiaries. It has not been used as leverage to address other budgetary concerns.

For the long term, the growing Trust Fund reserves, protected from non-Social Security budget demands, would add to the nation's economic prosperity and promote the creation of additional investment capital, goods and services to support retiring workers. Any roll-back of Social Security contributions would pre-empt a necessary build-up in Trust Fund reserves beyond one year's worth of benefit outlays as well as squander a unique opportunity in our nation's history to increase national saving.

Gwendolyn S. King is Commissioner of the Social Security Administration

These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Congressman Beryl Anthony to Address Tax Foundation R&D Tax Policy Seminar

The Tax Foundation will host a seminar on research and development tax policy on March 22 at the Hyatt Regency on Capitol Hill in Washington, DC. Approaching the theme "R&D Tax Policy: A Study in Conflict – Opportunity for Change," the seminar will set an objective policy debate on sound public and private R&D investment policies for the 1990s. Congressman Beryl Anthony (D-AR), member of the House Ways and Means Committee, will give the keynote address, and other top government, business and academic leaders (see program below) will examine current problems and viable solutions.

R&D Seminar Program

12:30 **Registration/Light Fare**

1:00 **Keynote Address**
Honorable Beryl F. Anthony
Democratic Congressman - Arkansas
Member, House Ways and Means Committee

1:30 **Issue Overview**
"Outlining the Conflicts in R&D Tax Policy"
John Magee
Partner
Miller & Chevalier

2:15 **Session One**
"Conflict in R&D Tax Policy and the Need for Change"
Chairman: Cyrus J. Halpern
Tax Vice President, Federal & International Taxes
AT&T
Edmund K. Harding
Manager of Tax Planning & Litigation
Xerox
Richard A. Grafmeyer
Minority Tax Counsel
Senate Committee on Finance
Stuart E. Eizenstat
Partner
Powell, Goldstein, Frazer & Murphy

3:30 **Break**

3:45 **Session Two**
"Mapping Out Sound R&D Policies for the 1990s"
Chairman: M.D. Menssen
Vice President, Taxes
3M
Dr. Anthony Billings
Professor
Wayne State University
Robert N. Mattson
Assistant Treasurer
IBM
Michael J. Graetz
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

5:30 **Cocktail Reception**
Special guests to be invited from:
Executive Office of the President
Department of the Treasury
Department of Commerce
Senate Finance Committee
Ways and Means Committee
Joint Committee on Taxation

To register, call 202-863-5454
Media Inquiries: Sedef Onder
All other: Paul Merski

NOTABLE

- **According to the National Science Foundation, 1989 saw the first real decline in R&D expenditures in 14 years.**
- **FY1991 Budget estimates receipts to increase three times faster than outlays.**
- **Each American's share of the federal debt will increase by $827 in FY1991.**
- **Federal participation in the credit market has increased from 18.4 percent in 1970 to 42 percent in 1989.**

Tax Features

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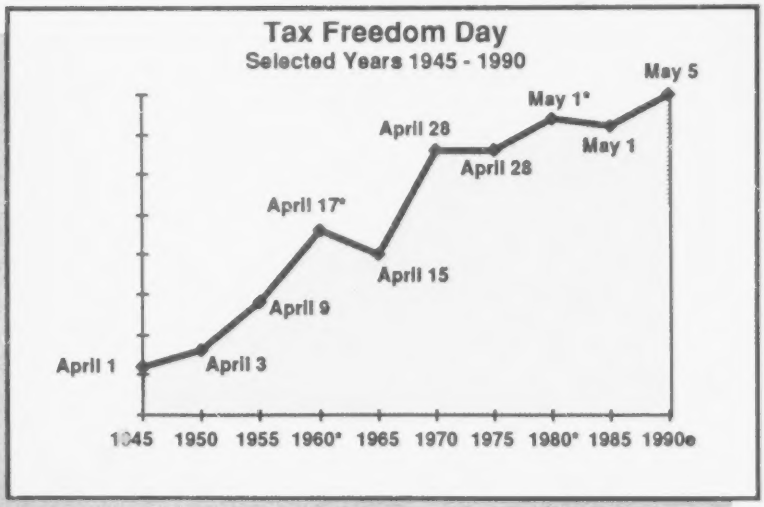
Tax Features

Tax Freedom Day Falls on May 5

1990's Date Is Latest Ever

As Americans scrambled to comply with the April 16 IRS filing deadline, they may have thought they would be free from the tax collector at the end of the day, but Tax Freedom Day doesn't come until May 5 this year.



The Tax Foundation has calculated that to be the day when the American taxpayer will have earned enough money to pay this year's total taxes. That means the average taxpayer will labor 125 days — from January 1 to May 5 — to satisfy all federal, state and local tax obligations, with every cent earned from the beginning of the year going to the tax collectors. Finally, on May 5, he will heave a sigh of relief and start pocketing some of his hard-earned money.

Especially bad news is that May 5th is the latest Tax Freedom Day ever. Last year this task required 123 days and Tax Freedom Day fell on May 3. The Tax Foundation attributes the two-day advance to several important factors: the base-broadening provisions in the Tax Reform Act of 1986; the January 1, 1990, increases in the Social Security taxable earnings base and tax rate; and the slowdown in

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Tax Foundation

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FRONT BURNER

The Price of Tax Freedom Is Spending Vigilance

Sen. Steve Symms

When someone says "Tax Day," almost all of us think of the middle of April. I applaud the Tax Foundation for again sounding the alarm clock on complacency and reminding us that the real "Tax Day" is May 5, two days later than in 1989. From January 1 to May 5, 1990, the average American is "working for the government."

Three primary topics of my constituent mail are taxes, the deficit, and requests for support of specific programs. Congress and many other Americans currently overlook the relationship among the three subjects.

We spend too much! It is really very simple: every nickel, every dime, and every million dollars has to come from somewhere. This coming year Congress will spend more than $1 trillion, or about $4,500 for every person in the country. There are two basic sources for that money: taxes and loans. "Tax Freedom Day" helps remind us who really pays for this.

The visible costs of overspending are increased taxes, and borrowing. The hidden cost is a negative effect which finally received public attention after Dr. Art Laffer graphically simplified it. He showed that when taxes go up there can be a corresponding, exponential decrease in economic activity.

There is a discussion about repealing the Gramm-Rudman law, which cuts federal spending across the board automatically if Congress doesn't reach specific spending targets. The last thing we should do is eliminate the only mechanism we have in place to limit spending.

One change we should make, however, is

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Steven Symms, Republican Senator from Idaho, serves on the Senate Committee on Finance.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

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to move the "Trust Funds" off budget, so they don't affect the Gramm-Rudman calculation. The trust funds are supported by dedicated taxes. We have gotten into the habit of running these funds at a surplus, then "investing" the surplus in bonds, whose proceeds go to funding various other programs within the government.

"Congress will spend more than $1 trillion, or about $4,500 for every person in the country. . . .'Tax Freedom Day' reminds us who really pays for this."

The surplus income of the Trust Funds in the "unified budget" appears to offset other spending. However, once the funds are called on to pay their obligations, the "bond investments" will have to be redeemed and the government will have to raise revenues (taxes) to pay them off.

This year the percentage of the budget that will go to pay interest on the loans which cover our deficits is about 13.5%. There are people who think that the deficit "solution" is raising taxes. Hopefully, we can convince these shortsighted people that any revenue gain lasts just long enough for people to pull their money out of our economy.

Our tax system penalizes production. You're taxed if you have earned a good job, recognized a good investment, or die after building a business or farm. One would think that we would want to encourage rather than discourage production and investment.

"The last thing we should do is eliminate [Gramm-Rudman] the only mechanism we have in place to limit spending."

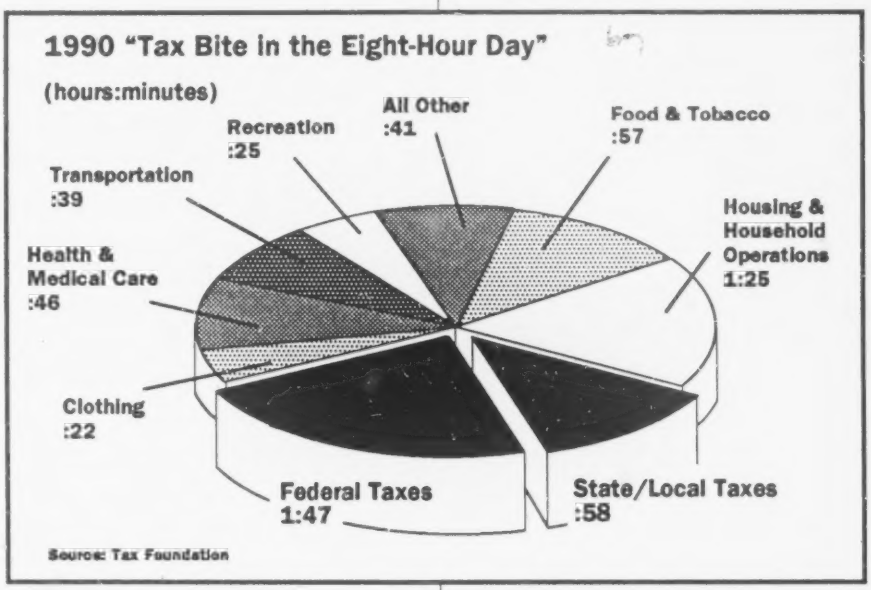
Let's get down to business. We must go back to basic economics and send more people to Washington who will work to lift restrictions on our economy instead of adding more weight to the sinker. Otherwise, "Tax Freedom Day" could eventually be in October!

1990 Taxes Take a Bigger Bite from The American Worker's Eight-Hour Day

Every year the Tax Foundation calculates the effect of the tax burden on the average worker's paycheck. This is the Tax Bite in the Eight-Hour Day.

In 1990, Tax Foundation analysts estimate that the average worker will spend 2 hours and 45 minutes of an 8-hour day working to satisfy federal, state and local tax collectors — three minutes more than in 1989. One hour and 47 minutes will go towards federal taxes while 58 minutes will be devoted to state and local taxes.

So with the bulk of his workday — 2 hours and 45 minutes — spent working for the tax collector, where does the average worker spend the remaining 5 hours and 15 minutes' worth of earnings? The largest portion is spent on housing and household operations: 1 hour and 25 minutes. Food and tobacco take 57 minutes while health & medical care costs absorb 46 minutes. Taxpayers will then work 39 minutes for transportation expenditures, 22 minutes for clothing, and 41 minutes for "all other" expenditures (personal care, personal business, private education, religious and welfare activities, foreign travel, and net savings). The typical worker spends the last 25 minutes' worth of income on recreation.



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economic growth. The nation's nominal income is estimated to grow only 5.7 percent while the the total tax take is projected to increase 7.2 percent. Stated simply, tax increases will outpace the growth in individuals' incomes during 1990.

Tax Freedom Day Outlook

It should be noted that Tax Freedom Day does not reflect the estimated $124 billion in federal deficit spending for 1990. It can be argued, of course, that the average worker does have a "share" of this deficit and will feel its effect through future increases in the tax burden and/or a weaker economy. This deficit, along with demands for new programs, budget crises in numerous states and the slowdown in income growth could easily make Tax Freedom Day even later on our calendars in future years.

Now Available

A new Tax Foundation Special Report computes Tax Freedom Day state by state. 6pp. $10 + $2 p/h.

Rep. Beryl Anthony Addresses Research and Development Tax Policy at Tax Foundation Seminar

Congressman Beryl F. Anthony (D-AR), member of the House Ways and Means Committee, gave the keynote address at the March 22 Tax Foundation seminar on research and development tax policy.

Approaching the theme "R&D Tax Policy: A Study in Conflict – Opportunity for Change," Congressman Anthony pinpointed the conflict: "It is a conflict, not in whether or not people believe in research and development . . . [but] between the need to balance the budget and the need to have a permanent national policy on research and development."

The congressman has led the fight for the R&D credit. "The current allocation regulations do not provide sufficient incentives for U.S.-based research activity and we must find a permanent solution to the problem." But Congressman Anthony was not optimistic about the possibility of resolving this conflict in favor of increased incentives for R&D. Referring to the continuing battle to make the credit for research and development permanent, Congressman Anthony opined "It has been in the President's budget three years in a row. We have accommodated the President by passing it." However, budgetary constraints have blocked the adoption of the permanent credit each time.

John Magee, partner in the law firm of Miller & Chevalier, followed Congressman Anthony with a complete overview of the R&D tax credit's legislative history, including examples of how it affects the behavior of the firms it is designed for. Originally enacted in 1981 as a 25 percent incremental credit, the research credit was reduced to 20 percent in 1986 as part of the overall reduction in rates implemented by the Tax Reform Act of 1986. Mr. Magee pointed out that this was by no means the largest reduction in the value of the credit to firms. "The value of the credit eroded over time and there have been obvious pressures on it, I think many of them attributable to the budget revenue problems that Congressman Anthony alluded to." Changes in the base used for the calculation of the credit and other technical rulings have cut into the value of the credit to the point that "in 1989 the Government Accounting Office estimated that the average effective rate for the credit in the period 1981 to 1983 was 3.5 – 5 percent." Mr. Magee continued, "for large multinational companies in the U.S., the credit has eroded to the point that it is a much less significant piece of the R&D picture," with one company reporting that the credit represents less than 2 percent of its annual R&D expenditures.

Panelists Michael J. Graetz, Deputy Assistant Secretary of the Treasury for Tax Policy, (at left) and John Magee, Partner, Miller & Chevalier.

Congressman Beryl F. Anthony (D-AR) addresses Tax Foundation's R&D seminar.

Edmund K. Harding, Manager of Tax Planning and Litigation at Xerox Corporation, brought the corporate tax practitioner's perspective to bear on R&D tax policy. He pointed to other nations' tax policies, finding them to be more favorable to R&D investment than those in the U.S., and he singled out the U.S. requirement to allocate R&D spending to foreign source income as a uniquely powerful disincentive. Mr. Harding then recounted the federal government's audit of Xerox's R&D credit, a story which spoke volumes about the burden of complying with complex U.S. tax law. He concluded by commenting, "With the administration, Congress, and even the man on the street all in favor of increasing R&D, just why tax incentives to accomplish that goal are drastically reduced and are also in danger of elimination is hard to figure."

Stuart E. Eizenstat, partner in the law firm of Powell, Goldstein, Frazer & Murphy and former domestic policy advisor to President Carter, offered a guided tour of the tortuous legislative and political history of the U.S. R&D credit. He stressed the urgency of making the credit permanent. "In today's international marketplace, the U.S. can remain competitive only if it stays at the forefront of technological innovation." He went on to assert that R&D policy should have other goals as well as stimulation of research and development. "Proper R&D policy must encourage a well-trained, scientific and technical workforce. . . . the education of our current and future scientists and engineers is totally and shockingly inadequate."

From left: Panelist Robert N. Mattson, Assistant Treasurer, IBM; Congressman Beryl F. Anthony (D-AR); and Wayne Gable, President, Tax Foundation.

Richard A. Grafmeyer, tax counsel to the Senate Finance Committee, gave the audience a snapshot of what the tax-writing committees' current thinking is on R&D. On the issue of whether or not the credit as it stands does in fact

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R&D from page 3

stimulate R&D investment or is too small an incentive to matter much, the committees "would like to wait a couple years . . . [to] see who is gaining by it . . . If it looks like it is providing incentive, obviously there is no reason to revisit it again." He was more sanguine on the subject of making the tax credit permanent. "There is finally an understanding on the Hill that corporate tax departments . . . [cannot] figure out the financing and budgets for long-term R&D projects without knowing what the law will be in the next year. . . . R&D is way up there on the A list of most Members." Mr. Grafmeyer made it abundantly clear, though, that all hopes for legislative action in Congress this year must be viewed in the shadow of the budget deficit.

Panelist Stuart E. Eizenstat, Partner, Powell, Goldstein, Frazer & Murphy.

Anthony Billings, associate professor of accounting at Wayne State University, reported on a study he had recently conducted which examined the economic factors that motivate or inhibit R&D expenditures. The ratio of debt to total capital was revealed to be a barometer of R&D activity: "R&D is a positive function of equity financing." Professor Billings' ultimate conclusion was that corporate integration was the tonic needed to stimulate R&D investment. "Tinkering with the incremental R&D credit formula" is too little too late.

Robert N. Mattson, Assistant Treasurer at IBM, began by urging government officials to recognize that R&D is an incremental, long-term process. However, when the government assesses an R&D effort in regard to the credit, it does so as if R&D could be put on a timeline — to have begun here and ended there. Mr. Mattson's next theme was the necessity for cooperation among corporations and universities here in the U.S. as well as the formation of joint ventures with foreign firms. "R&D for world class products in a world market will have to be undertaken anywhere in the world where the people, resources, and knowledge exist." Lastly, he urged the adoption of substantial tax incentives for R&D, far beyond mere technical corrections, citing studies which show the extraordinary benefits that accrue not only to the investor but to related industries and society as a whole.

Michael J. Graetz, Deputy Assistant Secretary for Tax Policy at the Treasury Department, spoke in favor of stabilizing R&D tax policy, rather than making substantive changes, so that firms performing research and development can make long-term plans. He also pointed out that the 1991 Bush budget does contain an increase for civilian R&D and a doubling of the National Science Foundation budget by 1993, so the desire to help the R&D effort is there, if only the will to implement these boosts can be found despite the federal budget deficit.

"The current allocation regulations do not provide sufficient incentives for U.S.-based research activity and we must find a permanent solution to the problem."

— Congressman Beryl F. Anthony (D-AR)

"In today's international marketplace, the U.S. can remain competitive only if it stays at the forefront of technological innovation."

— Stuart E. Eizenstat

New Tax Foundation Study Shows FY'90 Federal Tax Burden Up $81 Billion

Corporations Hit Hard; Individuals Hit Even Harder

Federal taxes will climb 8.4 percent in FY1990, from $963.4 billion in FY 1989 to $1,044.5 billion, according to a new Tax Foundation report entitled *Federal Tax Burden by State.*

This analysis of the projections in the President's 1991 Budget indicates that individual taxpayers will be hit with a 9.8 percent increase, up $43 billion from last year, while corporations will shoulder a burden 8.2 percent heavier in 1990.

Federal Tax Burden by State

The national per capita federal tax burden will rise $286 to $4,170 in FY 1990. When total federal taxes paid are ranked according to the per capita burden in each state, the largest tax burden is carried in the following nine states and the District of Columbia:

Connecticut	$6,768	Maryland	$5,046
New Jersey	6,239	N.H.	5,014
D.C.	5,770	Delaware	4,953
Mass.	5,577	Alaska	4,891
New York	5,178	Illinois	4,738

The average federal tax burden for citizens in these top ten states is $5,417, up $523 from FY 1989.

By contrast, the lowest burdens, averaging $2,849, are borne by taxpayers in the following states:

Mississippi	$2,451	Idaho	$2,891
Utah	2,731	S.Dakota	2,919
West Virginia	2,758	Louisiana	2,952
Arkansas	2,863	Kentucky	3,008
New Mexico	2,890	Montana	3,024

The Tax Foundation points out that citizens in the top ten states pay an average per capita tax burden that is $2,568 higher than that paid by citizens in the ten lowest per capita states.

Now Available

A new Tax Foundation Special Report entitled *Federal Tax Burden by State.* 12pp. $10 + $2 p/h. (Formerly the *Memorandum on the Allocation of the Federal Tax Burden by State.*)

PRESIDENT'S MESSAGE

Tax Foundation Mixes Popular and Technical Programs to Fulfill Educational Mandate

Wayne Gable

Each year, Tax Foundation economists hold up America's total tax burden to the calendar year and the workday of the average American. The results are Tax Freedom Day and the Tax Bite in the Eight-Hour Day.

The Tax Foundation does these analyses to fulfill its mission to educate Americans about the weight of government on the economy. The heavy press coverage we received this month indicates that the Tax Foundation has brought this information home to millions of Americans.

For example, the 1990 Tax Bite in the Eight-Hour Day is 2 hours and 45 minutes. This appears to be similar to the 2-hour and 43-minute Tax Bite in 1981, but a substantive difference is revealed when this chunk of the workday taken up by taxes is broken down into its federal and state/local components. In 1981, the breakdown was 1 hour and 52 minutes for federal taxes and 51 minutes for state/local taxes. In 1990 we find the burden falling much more heavily on the state/local side: 1 hour and 47 minutes for federal taxes and 58 minutes for state and local taxes.

This trend toward greater government spending at the state/local level has prompted us to conduct a much-expanded Tax Freedom Day analysis this year, computing a Tax Freedom Day for each state and the District of Columbia. We will continue to publicize Tax Freedom Day and the Tax Bite, as we did with our April 16 press conference, as long as we feel they educate people who are unaware of the true extent of government taxation and spending.

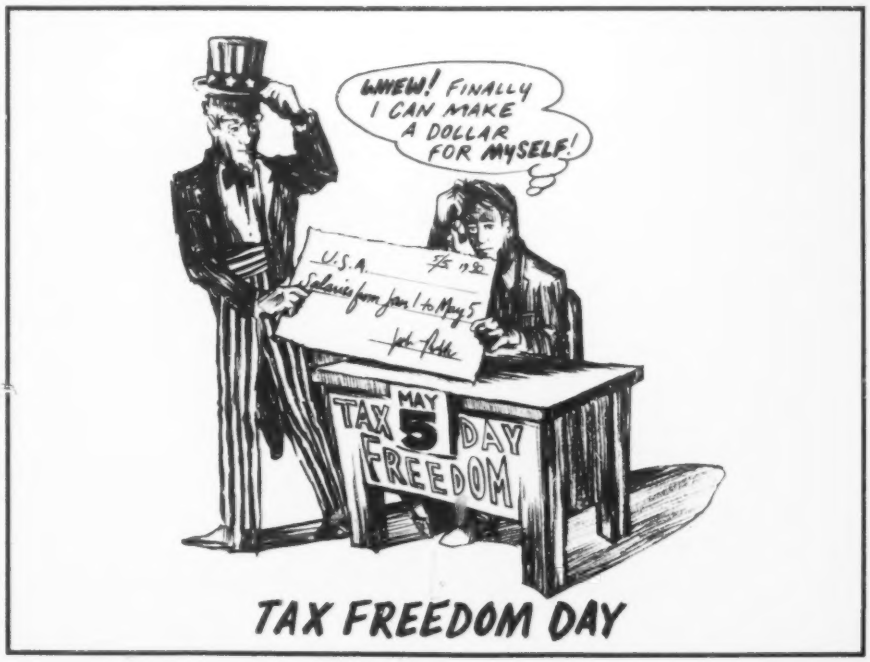
Reporters assembled for Tax Freedom Day press conference.

We do not stop, however, with grassroots and media education. We also serve to inform and educate specialists in the tax arena. The Tax Foundation's recent research and development tax policy seminar attracted government tax policy experts from here in Washington and corporate tax managers from around the country.

The Tax Foundation is fulfulling its stated mission to provide objective research and public education on the taxing and spending activities of government, and we will continue in our efforts to reach all Americans from the grassroots to tax specialists.

NOTABLE

- **Senate Budget Committee analysis of the Rostenkowski plan shows it reducing spending by $254.5 billion and raising revenue by $195.2 billion from 1991 to 1995. The Bush Budget would reduce spending $248.3 billion and raise revenues $16.8 billion.**
- **According to the CBO, if annual real declines of 2% in defense budget authority continue, as they have for 3 years, $91 billion in savings will be achieved from 1991 to 1995.**



Tax Foundation Joins With CSE Foundation For Tax and Budget Policy Conference

"Tax and Budget Policy: On Trial for the '90s" is the theme of a joint Tax Foundation/CSE Foundation conference on May 23, 1990, at the Hyatt Regency on Capitol Hill. After registration from 7 – 8:00 a.m., Senator Phil Gramm will address the conference. The luncheon speaker is the Honorable Jim Jones.

In the morning the Honorable Fred Goldberg, IRS; Charles McClure, Hoover Institution; Bernard Shapiro, Price Waterhouse; and Glenn White, Dow Chemical Co., will discuss tax complexity. Rep. Bill Frenzel; James C. Miller III, Citizens for a Sound Economy; and Henry Aaron, Brookings Institution, will discuss Gramm-Rudman-Hollings.

In the afternoon, state/local tax trends will be explained by Gary Wood, Texas Research League; Steven Gold, National Council of State Legislators; Sam Brunelli, American Legislative Exchange Council; and Elliott Dubin, Advisory Council on Intergovernmental Relations. Also, "The No New Taxes Pledge: One Year Later" will be addressed by Norman Ture, Institute for Research on the Economics of Taxation; and Robert Greenstein, Center for Budget and Policy Priorities.

A reception from 4:45 – 6:30 will follow the conference. Call 202-488-8200 for more information.

James C. Miller III and T. Boone Pickens to Address Tax Policy Seminar in Dallas

On Thursday, June 14, 1990, the Tax Foundation, in cooperation with the Financial Executives Institute and the Tax Executives Institute, will present a seminar in Dallas to address the economic/tax policy outlook. The program will feature a kickoff address by James C. Miller III, co-chairman of the Tax Foundation and former Director of the Office of Management and Budget under President Reagan. The luncheon speaker will be T. Boone Pickens, General Partner, Mesa Limited Partnership.

Panelists include John Boatright, Chief Economist, Exxon Corporation; W. Michael Cox, Vice President and Economic Advisor, Federal Reserve Bank of Dallas; Jared Hazleton, Director, Center for Business & Economic Analysis, Texas A&M University; Vernon W. Walker, President, Dallas Chapter of the Financial Executives Institute; and Paul Stein, President, Dallas Chapter of the Tax Executives Institute.

The program chairman is James P. Bryant, Vice President and Director of Corporate Taxes, J.C. Penney Company. The cost of the seminar, which is officially registered with the Texas State Board of Accountancy, is $100 per person. For additional information, contact Ron Bunn at 202-863-5454.

QUOTABLE

"At 3M, taxes are the second largest expense in the manufacturing area, exceeded only by raw materials."

— M.D. "Buck" Menssen, Vice President – Taxes at 3M, speaking at a Tax Foundation seminar in response to a question on the costs of plant location here in the U.S. and abroad.

Tax Features

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Tax Foundation Vol. 34, No. 5 May 1990

Tax Features

Senate Finance Committee Hears Gable Testify on Corporate Taxes

Wayne Gable, president of the Tax Foundation, testified on the corporate tax burden to the Senate Finance Committee on May 3, 1990.

Chairman Lloyd Bentsen and his colleagues on the committee were investigating the causes of lower-than-expected corporate tax receipts since the passage of the Tax Reform Act of 1986.

Wayne Gable testifies before the Senate Finance Committee on behalf of the Tax Foundation, one of only two private groups invited.

Gable presented evidence that the corporate tax burden is growing significantly, and that lower corporate profits are the main reason corporate tax revenues have not been higher. "In 1950, for example, corporate profits represented 18 percent of our national income. . . . In 1989, corporate profits account for a mere 6.8 percent of our nation's income."

Gable pointed out that federal corporate income taxes are only part of the picture. "They have risen 46 percent since 1980, but state and local corporate income tax revenues have increased 66 percent in that time. Combined, the federal, state and local corporate income tax take far surpasses the levels of the early 1970s."

The largest portion of the business tax burden, however, has become the corporate share of payroll taxes, "outstripping corporate income taxes and currently costing about $150 billion annually."

Full testimony available. Call 202-863-5454.

FRONT BURNER

Attacking the Budget Deficit: Two Views

Congressman Richard T. Schulze

Congressman Dan Rostenkowski

On p. 2, Chairman Dan Rostenkowski (D-IL) and his colleague on the House Ways and Means Committee, Richard T. Schulze (R-PA), address one of the nation's front burner issues: What action should be taken to solve our persistent budgetary problems.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Hastert and Grassley Introduce Tax Freedom Day Commemorative Legislation

Congressman J. Dennis Hastert (R-IL) and Senator Charles E. Grassley (R-IA) introduced a resolution on May 1 to designate May 5, 1990, as "National Tax Freedom Day."

According to Congressman Hastert, "We hear more and more calls for increasing taxes, supposedly for the purpose of balancing the budget. The fact is that Americans shoulder a heavier tax burden now than ever before."

Tax Freedom Day is calculated every year by the Tax Foundation. It determines the day on which the average American taxpayer has earned enough to pay his total tax bill, federal, state and local.

The frequent focus of news stories on just the income tax or the social security tax obscures the importance of knowing the weight of the total tax burden on the economy, which is measured by Tax Freedom Day.

A Special Report which computes Tax Freedom Day state by state is available from the Foundation.

Tax Foundation

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FRONT BURNER

Combine Spending Restraint with Taxes to Reduce the Deficit

by Dan Rostenkowski

Big budget deficits are bad news for America. They're bad for American businesses that can't afford the investment to become internationally competitive. They're an impediment for our children who will be asked in the future to pay the debts we're running up now.

And they cripple our government, which cannot respond to pressing needs like the war on drugs because of the budget straightjacket.

That's why I came up with my budgetary challenge to reduce the deficit by more than $500 billion in the next five years. More than half this amount would come from spending restraint, including moderate cuts in defense spending, and a one-year freeze on spending for other programs, excluding only those that help the poor.

But spending restraint alone won't do the entire job. Taxes must be increased also. I came up with some suggestions that would raise revenue in a way that would spread the additional burden throughout our economy without creating any unbalanced fiscal drag on our economy.

My suggestions are:

- a one-year freeze on tax indexing changes;
- elimination of the "bubble" so that the top marginal tax rate won't drop back to 28% once it hits the 33% level. This should only have an impact on about 1% of taxpayers;
- a 15-cent per gallon increase in the gasoline tax;
- increased cigarette, beer and wine taxes;
- new taxes on pollutants.

The impact of higher excise taxes on the poor would be softened by an expanded earned income tax credit. As a result, the entire package would yield a tax system moderately more progressive than the one we have now.

"I call my plan the Rostenkowski Challenge because it is intended to provoke discussion and encourage action. I ask my audience to analyze it and make suggestions for improvement. My only requirement is that the resulting package be as comprehensive as mine."

In my view, this is a balanced program. Together we've created this enormous fiscal problem. It is appropriate that we work together — in the

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Dan Rostenkowski, a Democrat from Illinois' 8th District, is Chairman of the House Ways and Means Committee.

FRONT BURNER

Reduce the Deficit by Cutting Taxes

by Richard Schulze

Despite rhetoric circulating on taxes today, the fact is, tax rates are still too high, wealthier taxpayers pay a greater share of taxes today than in past years, and historical evidence continues to show that tax cuts increase revenues. In addition, unless we greatly simplify the tax code, something Congress ignored in 1986, we face extreme problems in the near future. First, let me dispel some economic myths head-on!

Tax Myth: Tax increases on the rich are needed because they don't pay their fair share. Because of tax policy, the rich get richer and the poor get poorer.

Tax Truth: Wealthier taxpayers today pay a greater share of federal income and social insurance taxes than in 1980.

The wealthiest 20 percent of American taxpayers today pay 58.1 percent of federal income taxes collected by the IRS. In 1980, they paid 55.7 percent. The poorest 20 percent of American taxpayers pay the same 1.6 percent of federal taxes collected today as they paid in 1980. In other words, the rich are paying a greater share of taxes and the poor about the same.

"For each dollar of increased revenue in recent years, Congress has spent $1.58, far exceeding the budget requests of the Reagan and Bush Administrations."

A look at social insurance taxes finds the same trend. The top 20 percent of income earners pay 41.4 percent of social insurance taxes collected today, up from 38.9 percent in 1980 while the lowest wage earning Americans pay 3.3 percent today, down from 3.4 percent in 1980.

In fact, the frequently quoted studies purporting to prove our current tax rates unprogressive are flawed. In addition to focusing primarily on tax rates rather than total taxes paid, these studies fail to include as income government transfer payments – direct payments from the government to poorer Americans.

Tax Myth: American's are undertaxed and tax increases are needed to reduce the budget deficit.

Tax Truth: American families pay more than 40 percent of their income in taxes, and if anything, tax cuts are needed.

The tax cuts of 1981 managed to pull our economy out of a recession, and the 1986 tax reform act cut income taxes for individuals by lowering the top rate from 50 percent to 28

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Richard T. Schulze, a Republican from Pennsylvania's 5th District, is a member of the House Ways and Means Committee and Ranking Minority Member of its Oversight Subcommittee

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percent. Even with these "tax cuts," tax revenues have increased by over $50 billion per year, going from $517 billion in 1980 to a projected $1.073 trillion in 1990.

Clearly, the primary reason for the budget deficit has been runaway spending by Congress. In fact, for each dollar of increased revenue in recent years, Congress has spent $1.58, far exceeding the budget requests of the Reagan and Bush Administrations.

Tax Myth: Cutting tax rates, including the rate on capital gains, decreases available revenues for the federal government and increases the deficit.

Tax Truth: Recent history and taxpayer behavior prove that cutting tax rates increases revenues and spurs economic growth.

History proves that cutting taxes on capital gains assets, including homes, stocks, commercial property or other valuables, increases revenues to the Treasury. Who will benefit from these cuts? Over 74 percent of those reporting capital gains have wage and salary income under $50,000 per year.

Individual rate cuts also stimulate investment, economic activity and revenue growth. Lowering overall tax rates in the 1980s clearly showed an increase in individual income taxes collected. In 1986, tax rates dropped from 50 percent to 28 percent and 15 percent. Tax rates on individuals were cut substantially, yet, Americans paid almost $50 billion more in income taxes in 1987. Tax cuts, contrary to myth, increase revenues remitted to the Treasury.

Tax Myth: The 1986 Tax Reform Act simplified the tax code and increased tax collection efficiency.

Tax Truth: The 1986 tax act greatly added to corporate tax complexity and failed to remove taxpayers from the tax rolls.

A recent study by the National Association of Manufacturers found that in 1983, American corporations spent 66 cents to collect, account for, and pay each dollar of federal income tax. A subsequent study by the Tax Executives Institute found that the '86 Act increased corporate tax complexity as much as 191 percent for staff time, 1,025 percent for research time and 3,750 percent for the use of outside advisors. The conclusion one could easily draw is that U.S. corporations spend more to determine and pay their income tax liability than they ultimately pay. In most cases, corporations must calculate taxes three ways.

Why should this be of concern? It robs our economy of vital manpower to compete in an unforgiving world trading climate. No tax which costs more to collect than it raises is worthwhile or efficient. Simplification is essential for

See Schulze on page 4

PRESIDENT'S MESSAGE

Dubious Reputation of Budget Summits Makes All Parties Wary

Wayne Gable

Budget summits sound great in theory: politicians relax their posturing and huddle together to address a financial crisis. Does it really work that way, or is Rep. Leon Panetta's description of summitry more apt: "You've got boxers that have been throwing punches at each other for 10 rounds, and now you expect them to get together? It's not easy to stop in a hurry."

By the light of recent budget summits, the boxing analogy certainly holds. In 1987 and 1989, summits allegedly convened to lower the deficit ended up raising it, and the American people were knocked for a loop. Could it work well now? Well, past summit results don't leave us much room for optimism.

Participants in the 1987 summit emerged with a promise to reduce the deficit by $76 billion during FY1988 and '89. They intended to achieve the bulk of this savings by restraining $31.5 billion worth of spending and adding $28.3 billion in new revenue over the two years. What happened? In a nutshell, more tax revenue, broken promises on spending restraint, and higher deficits. The deficit actually rose $5.4 billion in FY1988, then remained stalled above $150 billion for the next two years.

The scene was played out again in 1989 with different characters but the same ending. Facing a requirement to reduce the deficit by $64 billion in February of 1989, President Bush arranged a confab with congressional leaders. The results: between 1989 and 1990, revenue increased $76 billion, spending increased $62 billion, and the deficit remained well above the $100 billion Gramm-Rudman-Hollings target.

Compare these years with FY1986, when growth in spending was held to 1.4 percent. The budget deficit fell $71.5 billion, setting an all-time record. When government revenue increases by billions of dollars, as it does every year, and spending growth is held in check, the deficit will drop. Ironically, we got much more deficit reduction *without* a summit.

Maybe this budget summit will be different. Current efforts to strengthen the budget process are laudable, and perhaps the personal diplomacy of President Bush will succeed where others have failed. My personal view, though, is that budget summitry holds out little hope. Ninety-five percent of Congress resents being excluded from the summit and is not bound by the agreements reached there — gone are the days when a handul of committee chairmen could crack the whip in Congress. Pre-summit comments sound more like shouts from ringside before the bell. The only concern of pundits is which political party will be left standing when the punches start flying. My fear is that the same party will take it on the chin as in 1987 and 1989 — the American taxpayer.

QUOTABLE

"I have a message for the President — Read my lips, keep the campaign pledge."

— Senator William V. Roth, Jr. (R-DE)
May 10, 1990

Tax Foundation Holds Budget Conference in Washington; Tax Policy Seminar in Dallas

"Tax and Budget Policy: On Trial for the '90s" is the theme of a joint Tax Foundation/Citizens for a Sound Economy Foundation conference on May 23, 1990, at the Hyatt Regency on Capitol Hill in Washington, DC.

The roster of distinguished speakers includes Senator Phil Gramm (R-TX); the Honorable James R. Jones, CEO, American Stock Exchange; the Honorable Fred T. Goldberg, Commissioner, IRS; Rep. Bill Frenzel (R-MN); James C. Miller III, Co-chairman, Tax Foundation; Henry Aaron, Brookings Institution; Rep. Leon Panetta (D-CA); and Rep. Christopher Cox (R-CA).

A reception from 4:45 – 6:30 will follow the conference. Call 202-863-5454 for more information.

"Economic/Tax Policy for the '90s" will be the theme on Thursday, June 14, 1990, in Dallas. The program will feature a kickoff address by James C. Miller III, co-chairman of the Tax Foundation, and a luncheon speech by T. Boone Pickens, General Partner, Mesa Limited Partnership.

The cost of the seminar, which is officially registered with the Texas State Board of Accountancy, is $100 per person. For additional information, contact Ron Bunn at 202-863-5454.

Rostenkowski from page 2

spirit of shared sacrifice — to resolve it.

In response to a White House concern, I added budget process reforms that would preclude Congress from spending new revenues rather than applying them to deficit reduction.

I call my plan the Rostenkowski Challenge because it is intended to provoke discussion and encourage action. I ask my audience to analyze it and make suggestions for improvement. My only requirement is that the resulting package be as comprehensive as mine is.

Some say my plan is too bold for our political system to embrace. I think it is no bigger than the problem. If I succeed, it will move the debate from blame placing to responsibility sharing.

Early response to the plan has been mixed. There have been positive responses from the White House, major corporate executives, trade associations, high school students and a few of my colleagues in Congress.

But a more common response from politicians is wariness. They're reluctant to endorse tax increases and have little faith that the budget process can become a positive force.

Obviously, they're responding to recent history.

I hope to generate enough public pressure to convince our leaders to move forward. Things have been stalled for too long. The stakes are too high to be ignored any longer.

Schulze from page 3

our businesses to compete.

Finally, individual taxes must also be simplified. The 1986 tax act dramatically increased record-keeping and compliance costs for most taxpayers who itemize deductions. Clearly, simplification was not the thrust of the 1986 tax act.

As a Member of the House Committee on Ways and Means, actively involved in all of the matters mentioned above, I will continue to work to simplify our tax code, see that progressive and constructive changes are made where necessary, and combat rhetoric concerning the tax myths being circulated in Washington, chiefly by those who want to increase your taxes.

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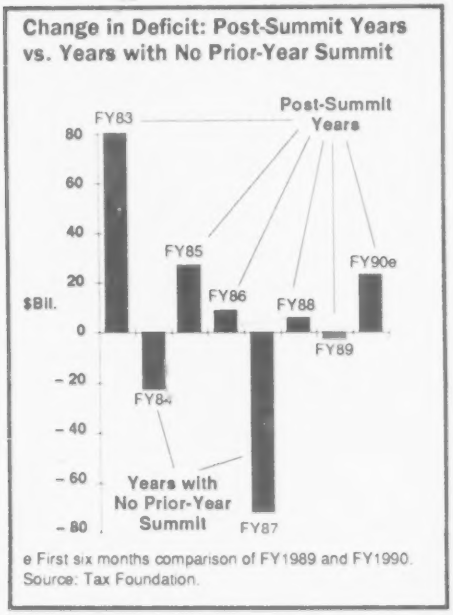
Tax Features

New Paper Traces History of Budget Summits in the '80s

Pattern of Deficit Reduction Shows Negotiations Ineffective

A new Tax Foundation analysis of budget summits during the 1980s entitled *A Decade of Budget Summitry* leaves little room for optimism that the current talks between the President and Congress will lead to deficit reduction. It points out that the FY1991 budget summit is the fifth time in nine years the White House and Congress have conducted special negotiations for this purpose, but the budget deficit has averaged well over $160 billion each year during this period.



e First six months comparison of FY1989 and FY1990.
Source: Tax Foundation.

In the first six months of the current fiscal year, the deficit exceeded $150 billion in spite of a full-year target of $100 billion. In light of these results, summits convened to lower deficits may have done more harm than good.

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FRONT BURNER

Budget Process Reform: Two Views

Start from Scratch with a Legislative Overhaul

Cong. Christopher Cox (R-CA)

The nation's budget process has broken down to the point that most Americans, if they understood it, would regard it as a national joke. But it is no laughing matter.

As a freshman congressman, I was struck right away by the utter incomprehensibility of the budget process. Virtually no member of Congress — let alone the public — even reads the huge spending bills we adopt. Moreover, the typical year-end, catch-all spending bill is too long, too complex, and too tardy to expect the President even to read it before he must sign it into law.

On my first day in Congress, then Speaker

Congressman Marty Russo (D-IL)

Honesty Is the Best Budget Policy

When I talk about the budget process, I do so as a member of the Budget Committee who cannot wait to finish serving his last year on it. The budget process is so flawed that it has become a fraud. It is a sham, and one of the most important reasons we have the fiscal woes we do today is that the Budget Committee, along with the Administration and the rest of Congress, has been sliding by the problems for the last nine years.

I hope that as a result of the current budget summit, if nothing else is done, the summiteers will be honest about the problem and honest about the solution. I for one do not

See Russo on page 2, col. 3

Tax Foundation

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Cox from page 1

Jim Wright declared that he was going to violate the law. This may shock most Americans, but in fact it is routine business in Washington. You see, Speaker Wright promised to pass all of that year's spending bills by August. In fact the law requires final action on these bills by June 15th.

Ordinarily it might seem brazen for a newly elected congressman to attempt to refashion what the system has been producing for a long time. But the frustration with the way the budget process has disintegrated is growing to the point that now a fresh approach may be just what is needed.

For that reason, I will soon be introducing a total rewrite of the 1974 Congressional Budget Act. My proposal calls for Congress to enact, on or before May 1, a simplified budget that would fit on one page. This binding "budget law," once passed by Congress and signed by the President, would set legal ceilings on spending in 19 major categories. These are legal limits, not "guidelines"; Congress would not be free to violate them or ignore them when it seemed convenient.

"As a freshman congressman, I was struck right away by the utter incomprehensibility of the budget process. Virtually no member of Congress — let alone the public — even reads the huge spending bills we adopt."

Until that budget is in place, it would be out of order for the House or Senate to consider any spending legislation in subcommittee, committee or on the floor. Once the budget is adopted, Congress could authorize expenditures by majority vote, provided we stayed within the ceilings. To break one of the ceilings, it would take a two-thirds vote. But even then, the President could use enhanced rescission authority — "line item reduction" if you will — to bring these super majority-approved budget busters back down to the totals originally agreed upon by the Congress.

"My proposal calls for Congress to enact, on or before May 1, a simplified budget that would fit on one page. This binding 'budget law,' once passed by Congress and signed by the President, would set legal ceilings on spending in 19 major categories. These are legal limits, not 'guidelines'; Congress would not be free to violate them or ignore them when it seemed convenient."

Finally, if the Congress and the President fail to do anything at all, an automatic continuing resolution would fund the government at last year's levels — thereby insuring we don't face the dilemma of shutting down the government or signing a massive, last-minute, catch all spending bill. The prospect of no change whatever in last year's spending would also provide an enormous incentive for both Republicans and Democrats to get to work on a real budget.

The Gramm-Rudman-Hollings targets were aimed at addressing our gargantuan annual deficits, and they have helped. But they do not go to the heart of the problem, which is an undisciplined, runaway budget process.

It is time to harness this wild animal. My bill will be ready for submission this session. Soon we will discover whether Congress is serious about its responsibilities to the taxpayer, to our economy, and to future generations of Americans.

Christopher Cox, a Republican from California's 40th District, began service in 1989 and is Co-Chairman of the House Republican Research Committee's Budget Reform Task Force.

Russo from page 1

favor any new taxes as a solution to the mounting deficits. I think we can handle them by dealing with the spending side of the ledger, with cuts in both military and non-defense spending.

I think the American public is prepared to make sacrifices if we will tell them once and for all exactly what the problem is and exactly how we intend to solve it. It ought to be a bold approach that will attack the problem over a five year period. The citizens understand that there is a serious problem. Of course, they are very cynical today because every time we need to meet a Gramm-Rudman target, we somehow manufacture a way by asset sales, payday shifts, and faulty assumptions. This is done by both the Administration and the Congress. After we do all that, we say we have met the target. Then as soon as we get into the next fiscal year, CBO comes out with a budget that says we didn't hit the target — the deficit is not really $100 billion — it is really $161 billion. We have been doing that now for the five years that I have been on the Budget Committee. So, either we change the process and get honest, or we ought to get rid of the budget process.

"I for one do not favor any new taxes as a solution to the mounting deficits."

I think the summit is a rare opportunity for the Congress to work with the President — if he is prepared to make the tough decisions necessary to deal with the massive problem. The problem has many components: The economic assumptions are $22 billion off; Medicare and Medicaid costs are going up; there is a shortfall in FDIC premiums; and the cost of food stamps is going up. The Administration knew of these problems before it sent its budget to Congress. But the biggest hit we are going to take is the S&L bailout. That is anywhere between $50 and $100 billion this year alone. So if you take the

Rep. Marty Russo, a Democrat, has served the 3rd District of Illinois since 1975. He serves on the Ways and Means and Budget Committees, and is Deputy Majority Whip.

worst case scenario, the deficit is $186 billion higher than projected. If you take the best case scenario, it is $86 billion off. It depends on how you calculate the numbers.

So the question is, what do we do about it? We just had a meeting with some of our summiteers. Some of us told them that they should be honest, tell us what the problem is, what we need to do, and how we need to do it. And don't come back with payday shifts and other budget gimmicks, the kind of games that have made people in this country cynical about what comes out of Washington.

The Chairman of the Ways and Means Committee has made it very clear that until he has an agreement with the President on what is needed from his committee, he is not going to offer anything and move it through the committee. So, unless and until the President decides he wants revenue as part of his solution and works it out ahead of time, I don't think we will see the Ways and Means Committee moving forward.

"The summit is a rare opportunity for the Congress to work with the President — if he is prepared to make the tough decisions necessary to deal with the massive problem."

Personally, I think you can do it without taxes. It will require a severe hit in the Defense Department, and it will take some hits in the domestic side. For example, one of the things I would recommend we do is eliminate plans for the space station. We don't need to put people out in space when others can't find homes on earth. That can wait. This year we are giving the Defense Department $295 billion in our budget. Last year they got $296 billion. If you can believe David Stockman, there is about $30 – $40 billion of waste in the Defense Department. I will take David Stockman at his word. We need that kind of honesty now if we are to restore sanity to the budget process and prosperity to the nation.

Tax and Budget Conference Brings Government and Industry Leaders Together During Budget Summit

The Tax Foundation held a conference on tax and budget issues in cooperation with Citizens for a Sound Economy Foundation on May 23 in Washington, DC. Corporate executives, members of congressional and executive agency staffs, and of the business press heard presentations from experts in the fields of state taxation and tax complexity, as well as more general discussion of public finance from well-known politicians and economists.

Senator Phil Gramm (R-TX) began the conference by pointing out that the federal budget process was never intended to restrain federal spending and that the budget committee in the House was originally structured to prevent its becoming a source of power. The senator said the Gramm-Rudman-Hollings bill was "the only budget reform that was ever aimed at trying to have a real impact on the deficit." As to whether it has been effective, he pointed out several shortcomings and possible improvements, but cited three developments which prove that overall, the legislation has had a positive impact.

"The Gramm-Rudman-Hollings balanced budget bill was the only budget reform that was ever aimed at trying to have a real impact on the deficit."
—Senator Phil Gramm (R-TX)

First, since the law went into effect, the deficit has been reduced in real terms. Second, for twenty years prior to its enactment, federal spending grew an average of 11 percent annually, compared to 3.8 percent after passage. Third and most important, federal government has begun to grow more slowly than the private sector.

The Burden of Tax Complexity

Lee Sheppard, contributing editor of *Tax Notes*, moderated the first panel on the program. It focused on the complexity of tax compliance, featuring Glenn White, Director of Taxes at Dow Chemical; Charles McLure, senior fellow at the Hoover Institution; Bernard Shapiro, National Director of Tax Policy, Price Waterhouse; and Fred Goldberg, Commissioner of the IRS.

Senator Phil Gramm (R-TX), talks with James W. Nethercott (L), Senior Vice President, The Procter & Gamble Company, and a member of the Tax Foundation's Policy Council.

Glenn White started by citing a much-quoted study by the A.D. Little Company showing that in 1983, corporations in the U.S. spent 2.7 billion hours calculating tax liabilities, the normal work product of 1,350,000 people in one year. He decried the Tax Reform Act of 1986 for worsening the situation and gave anecdotal evidence of his own company's travails in trying to deal with the ever more complex code.

Charles McLure picked out a few areas that are sources of complexity — fringe benefits, low income provisions, and anti-shelter provisions like the alternative minimum tax — but pointed out that the only alternative to complexity in these areas is inaccuracy and distortion of economic decision-making. He outlined instead a more fundamental change in corporate taxation which, among many changes, would allow "immediate write-off of all purchases, whether for inventories, intermediate goods, or capital goods." Aside

Briefings in Pittsburgh and Washington Keep Members Attuned to Budget Issues

Senior Tax Foundation staff met Foundation members and other corporate leaders in Pittsburgh for a briefing on the current budget debate. From left to right: Richard Larry, President, Sarah Scaife Foundation; Wayne Gable, President, Tax Foundation; James W. Wirth, Senior Vice President & CFO, Aluminum Company of America; James C. Miller, III, Co-Chairman, Tax Foundation; Robert A. dePalma, Senior Vice President & CFO, Rockwell International; W. Bruce Thomas, Vice Chairman - Administration & CFO, USX Corporation.

Tax Foundation Co-Chairman James Q. Riordan (L) with Lawrence Lindsey, Special Assistant to the President for Domestic Policy Development, during a briefing at the Old Executive Office Building in Washington, DC.

Tax Foundation Vice President Dan Witt (L) exchanges a word with Michael Darby, Under Secretary for Economic Affairs at the Department of Commerce, before a presentation Mr. Darby made to the Tax Foundation's Program Committee.

Anthony Billings Joins Foundation Research Staff

Anthony Billings has joined the Foundation's staff as a senior research fellow. An associate professor of accounting at Wayne State University, Professor Billings' articles have appeared in the *Journal of Accountancy* and numerous other professional journals.

He has studied international tax problems for Dow Corning and 3M, and at the Tax Foundation he will be undertaking a major study of U.S. taxation of American firms doing business abroad.

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from the economics of these proposals, McLure stressed the relative ease of their administration.

Bernard Shapiro outlined the major budgetary legislation of the 1980s. He described ERTA's $750 billion tax cut over five years as "clearly too big . . . but the biggest problem was that it was uncoupled with a spending cut." The huge deficits that resulted have played a major role in budgetary and Presidential politics since then.

James Q. Riordan (L), co-chairman of the Tax Foundation and chief executive officer of Bekaert Corporation, talks with Larry Wilson, general tax counsel at Unocal Corporation.

And combined with the repeal of indexing, they have contributed to tax complexity as legislators look for small pockets of revenue in the code. Mr. Shapiro predicted that the budget summit in progress would bring a major tax bill of at least $15 billion in new revenue.

Fred Goldberg asserted the view that much complexity resulted from perceived abuses of the code. He also sees complexity arising from a well-intentioned attempt to be equitable that ends up in a mire of rulings that are attempts to solve individuals' problems. He closed with a warning that although some may view repealing the corporate income tax as a good simplification, revenue issues are everpresent, deficits are real, and revenue-neutral proposals are the ones that get serious consideration.

Gramm-Rudman-Hollings

The theme of the second panel was "Gramm-Rudman-Hollings: Save It or Scrap It?" James C. Miller, III, Co-Chairman of the Tax Foundation, defended Gramm-Rudman on its record, pointing out that when it has been enforced, the deficit has been substantialy reduced.

Congressman Bill Frenzel (R-MN) also spoke in its defense, but both he and Mr. Miller called the sequester a "meat-ax approach" to budgeting that should be avoided.

Henry Aaron, senior fellow at the Brookings Institution, argued against Gramm-Rudman as a mere procedural distraction from the central issue of what and whom should be taxed.

"Fiscal Policy in the 1990s" was the general theme for the luncheon speaker, the Honorable Jim Jones, Chairman of the American Stock Exchange. Mr. Jones reiterated his long-held belief that "the deficit and national debt are the overriding issue this country has to solve if we are going to have good economic conditions for decades and generations to come." In the investment area, he argued for a capital gains differential and would tie that reduction in the rate to a holding period of at least one year to promote longer term investing. Also, he would favor initiatives to even out the debt vs. equity bias in LBOs.

On the spending side, Mr. Jones is pushing investment in human capital — education and retraining. He sees a labor shortage coming and insists we must improve our labor pool. Aside from education, infrastructure improvements and research and development are at the top of his list of spending priorities.

State and Local Taxes

Gordon St. John Gilman, Tax Attorney, Texaco, Inc., moderated the state/local panel, and after pointing out some particular state-level problems he faces in his role as head of the Dallas Chapter of the Tax Executives Institute, he introduced the panelists. They were Duane Parde, Director of the State Legislature and Private Sector Task Force at the American Legislative Exchange Council; Elliott Dubin, an analyst with the Advisory Council on Intergovernmental Relations; and Steven Gold, Director of the Center for the Study of the States at the Rockefeller Institute.

These experts testified to increasing tax burden at the state level. With less federal assistance than in the 1950s and '60s, states have been raising revenue and may continue to do so at a rate higher than the increase in personal income.

"The deficit and national debt are the overriding issue this country has to solve if we are going to have good economic conditions for decades and generations to come."

—Jim Jones, Chairman, American Stock Exchange

The "No New Taxes" Pledge

Two politicians and two budget analysts discussed the current budget crunch and debated the need for new revenues. Marty Russo (D-IL) and Christopher Cox (R-CA) gave two Capitol Hill viewpoints while Norman Ture, President of the Institute for Research on the Economics of Taxation, and Robert Greenstein, Director of the Center for Budget and Policy Priorities, debated the relative importance of the deficit to the economy. The panel was moderated by Paul Gigot, editor, *Wall Street Journal*.

Congressman Bill Frenzel (R-MN) is flanked by Henry Aaron, senior fellow in economics at the Brookings Institution, (L) and James C. Miller III, co-chairman of the Tax Foundation and former director of the Office of Management and Budget.

Budget Summit from page 1

Talk Is Expensive

Throughout the 1980s the White House and Congress have generally been locked in a budgetary stalemate, impeding any significant deficit reductions. The high-level budget talks held in 1982, 1984, 1985, 1987 and 1989 all fell far short of their stated goals.

Ironically, the fiscal years that were not preceded by budget summits actually resulted in the most real deficit reduction (see figure on page 1). For example, in FY1984, the deficit dropped $23 billion when spending growth was held to 5.4 percent — half the rate of revenue growth for that same year. Again with no summit agreement in force, FY1987 spending grew only 1.4 percent and the budget deficit fell a record $71.5 billion. Conversely, the fallout in fiscal years with negotiated deficit reductions was higher taxes and higher deficits.

Historical Overview

The analysis begins by showing how the well-intentioned negotiations of 1982 and 1984 went awry, concluding, "Any plan that promises to balance today's tax hike with tomorrow's spending cuts is unsound. Taxes once enacted into the code are collected, but long-term spending cuts demand constant discipline."

Congress vented its frustration with the deficit by passing the Gramm-Rudman-Hollings law in 1985, but a budget accord reached earlier in the year with the President fared no better than in 1982 and 1984. In fact, the deficit reached an all-time high of $221 billion in 1986.

The October 19 stock market crash and the looming $23 billion in automatic spending cuts under Gramm-Rudman-Hollings were the cue for high-level deficit reduction talks in 1987. After weeks of closed-door negotiations, the 1987 summit emerged with a plan to trim the deficit $76 billion over the next two years. What resulted was a $5.4 billion increase in the deficit in FY1988 and a FY1989 deficit $11 billion over the summit target. Also, the Gramm-Rudman-Hollings deficit targets were rewritten, postponing the promise of a balanced budget from 1991 to 1993.

During the budgetary stalemate in 1989, the President and Congress were forced to contemplate across-the-board spending cuts mandated by Gramm-Rudman's "sequester." The President and Congress substituted budget summitry for the full sequester, however, and the result was $6 billion in new taxes and one-time savings gimmicks designed to hit a $99.4 billion FY1990 deficit target.

The Current Negotiations: Will History Repeat Itself?

In 1990, fears of a slowing economy and possibly $100 billion in across-the-board spending cuts have sparked deficit negotiations between the White House and Congress. Hopefully, these new talks will actually result in lower deficits. Only 10 of the last 62 budgets paid their own way without deficit spending, and in none of the last 21 years has the budget been balanced. Unfortunately, judging by recent budget summit history, a deficit reduction deal could be a bad deal for taxpayers.

Now Available

A new Issue Brief entitled *A Decade of Budget Summitry,* 4pp. $10 + $2 p/h.

PRESIDENT'S MESSAGE

Globalization of Economy Makes U.S. Tax Policy Seem Parochial

Wayne Gable

Muscovites must be getting used to the golden arches of McDonalds on Pushkin Square. Since opening on January 31 of this year, the Moscow McDonalds has done more business than any McDonalds in the world — the nearly 1,000 Soviet employees there are serving up nearly 50,000 meals a day. Canada's Olympia & York has unveiled plans to extend Moscow's international trade center, and Skanska, a Swedish developer, has joined with five Hungarian state agencies in Budapest's first joint venture office development.

The news is filled with such stories of burgeoning investment opportunities abroad: Eastern Europe, Mexico, the Pacific rim, and even the Soviet Union are opening up. In the past decade, the growth in world trade has far outstripped the growth rate in domestic demand for goods and services. So the watchwords are competitiveness and globalization — how will U.S. firms match up head to head with foreign-based companies in the world marketplace? Some pundits are pessimistic, citing high-tech manufacturing prowess in Japan and the proximity of West Germany to Eastern Europe as reasons that companies based there will prosper.

We at the Tax Foundation are urging policymakers in Washington to realize that U.S. tax policy is a critical component of competitiveness, one that can have a dramatic impact on the fortunes of U.S. firms. Tax Foundation members have made clear in a survey taken earlier this year that they want more research done on the taxation of U.S. firms doing business abroad. Consequently, the Tax Foundation's new senior research fellow Dr. Anthony Billings (see page 6) will initiate a multi-year project on the subject, exploring how various tax provisions help or hinder U.S. competitiveness.

We must remember that international competitiveness depends not only on the innovation of U.S. firms but also on their ability to operate abroad without punitive tax laws holding them back. As the record number of Big Macs selling at the Moscow McDonalds reveals, foreigners do want American products. It is up to us to make sure we don't allow an uncompetitive tax policy to prevent American enterprise from taking those products to foreign lands.

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Tax Features

'Bubbles' Abound in Tax Code, Used by Legislators to Enhance Progressivity

When legislators suggest that we "pop the bubble" in the individual income tax rates, they usually describe the bubble as an "anomaly" or "mistake." Their proposals are supposedly a "correction" or "clarification" of the tax code, as if the code were a simple, elegant structure with one nail sticking up out of it, and all we have to do is hammer it down. Nothing could be further from the truth.

The tax code is in fact enormously complex and is filled with with many so-called bubbles. How do they occur and what does popping them really mean?

The notorious bubble in the individual income tax rate structure arises because of two special provisions under the code: 1) Income below $18,550 (single filers) is taxed at 15 percent rather than at the 28 percent marginal rate to which all other income is subject; 2) Each taxpayer is entitled to a personal exemption of $2,050 (1990). The money saved by using the 15 percent rate, $2,412, [(28%–15%) * $18,550] and from the personal exemption, $574, (28% * $2,050) is recouped from the taxpayer by adding an extra 5 percent tax to the 28 percent top statutory rate. This 33 percent rate is applied to income between $44,900 and $104,610 (for single individuals) until the $2,986 is fully recovered.

In other words, to take away from high-income earners the advantage of both the 15 percent rate and the personal exemption, a 5 percent surcharge is imposed on a specific range of income — at the beginning of the range, the marginal rate rises; at the end it falls back, forming the bubble.

It is the lower marginal rate for income beyond the bubble that proponents of bubble-popping claim to be unfair. But they rarely if ever point out that the bubble is only in marginal rates, not effective rates. With the bubble in place, no taxpayer ever pays a lower effective rate by earning more.

Bubble-poppers show their true colors

See Bubbles on page 3

FRONT BURNER

Investment and Capital Gains Indexing

Sen. William Armstrong

Every now and again, an idea comes before Congress which is so compelling you think surely it will be enacted into law. Capital gains indexing is just such an issue. Only a passing acquaintance with tax policy is needed to grasp how unfair it is to tax phantom capital gains due to inflation. Such common-sense appeal explains why support for indexing covers the political spectrum. Yet, year after year, capital gains indexing doesn't quite make it into law.

But it should.

Because fairness has played such an important role in the formulation of tax policy, advocates of indexing have focused on the unfairness of taxing inflationary gains. So it should not be surprising that there remains some confusion as to how indexing affects the incentive to invest relative to an exclusion.

Contrary to popular belief, indexing can provide a much greater tax benefit to a vast majority of shareholders than would a 30% exclusion. A simple example can illustrate this point:

Suppose you purchase a share for $100 and you hold it for five years. Over that period, the annual inflation rate is 5%, and you face a 28% tax on your gains. In this case, only if your cumulative, pre-tax return exceeds 92% will the President's proposal provide as much tax relief as does indexing. On an annual basis, that translates into a total annual return of 13.5% for each of the five years. While some

See Armstrong on page 2

William Armstrong, Republican Senator from Colorado, serves on the Senate Committee on Finance.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

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Armstrong from page 1

businesses offer their owners such high rates of appreciation, certainly far less than a majority perform so well. So, for the majority of American shareholders and businesses, indexing is the better way to go.

"Only a passing acquaintance with tax policy is needed to grasp how unfair it is to tax phantom capital gains due to inflation."

For some assets bearing taxable nominal gains, once the tax basis is adjusted for inflation, we find these same assets yield real losses. While correct tax policy dictates that a taxpayer should be allowed to deduct his real loss from any taxable income, the fact of the matter is the revenue drain of such a proposal would be prohibitive. Moreover, it might be too expensive even to allow a taxpayer to charge his real losses against his real gains. Many indexing proposals, therefore, would not allow taxpayers to use real losses to offset other gains or other income.

Some have argued the difficulty posed by tax losses due to indexing implies that indexing is, itself, somehow defective policy. Nothing could be further from the truth. The real capital loss problem arises because capital gains indexing works so well to eliminate the tax on phantom gains.

A second example will serve to make this point clear:

Suppose you buy one share each in Company A and Company B, each share costs $100, inflation and tax rates are as before, and you hold both shares for five years. Company A's shares appreciate at the rate of 4 percent per year and B's appreciate at 15 percent per year. After five years, you will pay almost $25 in combined capital gains tax under the President's proposal.

If you are allowed to index your tax basis, your share in Company A shows a real loss which, we assume, you are unable to charge against any real gains or other income. So there is no tax consequence to the purchase and sale of this share.

The appreciation of Company B's share leaves you with a tax liability of just under $22 after indexing. When the tax consequences of both purchases and sales are combined, indexing will save you $3 in tax as compared to the President's plan, even though, under indexing, you lost any benefit from using the tax loss from the underperforming share.

"Contrary to popular belief, indexing can provide a much greater tax benefit to a vast majority of shareholders than would a 30% exclusion."

There is another reason to support indexing. As recent history has shown, capital gains exclusions tend to be short-lived. If we enact an exclusion this year, we can be certain the next time we try to reform the tax code, repeal of the exclusion will be a key means of paying for it, just as it was in 1986. But indexing, once enacted, is much more likely to remain a long-term fixture of our tax system. If we reduce the capital gains tax, in part to encourage long-term investment, we should be sure the changes will last more than a few short years.

"If we enact an exclusion this year, we can be certain the next time we try to reform the tax code, repeal of the exclusion will be a key means of paying for it, just as it was in 1986. But indexing, once enacted, is much more likely to remain a long-term fixture of our tax system."

Tax Foundation Report Explodes the Myth of Popping the Bubble

A new report entitled *The Myths and Misunderstandings of Popping the Bubble,* published by the Tax Foundation and authored by Byrle M. Abbin, asserts that the "bubble," despite its appearance, is not regressive and is preferable to the proposals that have been put forward to eliminate it. The "bubble" is a 33 percent marginal tax rate levied at certain taxable-income levels in order to phase out the benefits of the 15 percent tax bracket and the personal exemptions for high-income taxpayers.

Mr. Abbin, managing director, Office of Federal Tax Services at Arthur Andersen, points out that any plan to "pop the bubble" by levying a 33 percent rate on all income above these ranges will increase pressure to "reverse the basic tradeoff of lower rates for a broader tax base that formed the foundation of the Tax Reform Act of 1986."

Abbin goes on to cite statements by members of Congress from both sides of the aisle, Senator Bill Bradley (D-NJ) and Rep. Richard Schulze (R-PA), who understand the purpose of the bubble. Bradley is quoted in a "dear colleague" letter: "'Unfortunately, many people believe — incorrectly — that taxpayers subject to the 33% rate are being treated unfairly compared to higher income taxpayers whose top marginal rate is 28%. In fact,' Bradley continued, 'the bubble does not reward the rich. On the contrary, it enhances the tax system's progressivity.'"

Finally, Abbin addresses the issue of motive for changing the rate structure. He suggests that while the bubble could be eliminated in a revenue-neutral fashion, most proposals to do away with it talk about "fairness and clarity" but would in fact yield billions of dollars in additional tax revenue.

Now Available

A new Tax Foundation *Issue Brief* entitled *The Myths and Misunderstandings of Popping the Bubble*. By Byrle Abbin, 4 pp. $10 + $2 p/h.

Bubbles from page 1

when they propose alternatives. Although it is quite possible to eliminate the bubble without raising or lowering federal revenue, their most common suggestion is to extend the top of the bubble over the rest of the income range, creating a separate, higher marginal rate. This would extract billions of extra tax dollars under the guise of fixing the tax structure.

Bubbles Bubbles Everywhere

The individual income tax rate bubble has received much attention, but it is by no means the only bubble. Simply put, a bubble arises whenever the law requires a tax benefit or advantage to be reduced or eliminated as income increases. The net effect is to raise the effective tax rate of higher-income taxpayers compared to lower-income taxpayers who retain the full benefit of the provision.

Indeed, if Congress began popping every bubble it could find in the manner suggested above, it would affect not only take-home pay, but rental real estate income, effective corporate income tax rates, the applicability of the alternative minimum tax, and the child care credit, just to name a few.

The Corporate Income Tax Bubble

Corporate taxpayers are also subject to a rate structure bubble because some income is taxed at 15 percent (first $50,000 of taxable income) and some at 25 percent (between $50,000 and $75,000), rather than having all income taxed at the top rate of 34 percent. Taxable income above $100,000 is subject to an extra 5 percent tax rate until the tax saved from using the lower tax rates is fully recouped ($335,000). The process of computing the corporate income tax is similar to that of computing the individual income tax. Therefore, the rate surcharge was applied to both corporate and individual taxpayers to accomplish the same purpose.

The Earned Income Credit Bubble

The earned income credit bubble arises because the rate of credit is decreased and eventually eliminated as adjusted gross income (AGI) increases. The code allows a tax credit equal to $953 or 14 percent of earned income, whichever is lower. The credit is reduced by 10 percent of AGI or earned income over $10,730 and is eliminated when AGI exceeds $20,264. Therefore, the bubble denies the credit to higher-income taxpayers, enhancing progressivity.

The Rental Real Estate Bubble

Individual taxpayers are able to deduct as much as $25,000 of rental real estate losses annually. However, taxpayers with AGI in excess of $100,000 must reduce the $25,000 amount by 50 percent of each dollar of modified AGI (AGI after certain adjustments) in excess of $100,000. The result is that taxpayers with modified AGI higher than $150,000 ($100,000 + $50,000) cannot currently deduct otherwise deductible rental real estate losses. The phaseout of the deductible rental real estate losses creates a bubble and accomplishes a purpose similar to the 5 percent surcharge in the individual and corporate rate structures.

The Alternative Minimum Tax Bubble

The Alternative Minimum Tax includes a built-in bubble because the code requires a phaseout of the $40,000 exemption in computing the AMT liability. The $40,000 exemption amount serves as a floor in determining whether or not individual or corporate taxpayers are subject to the AMT. The AMT generally will not apply unless alternative minimum taxable income (AMTI, taxable income plus tax preferences and adjustments) exceeds the $40,000 exemption, after considering the phaseout.

The phaseout is applied to corporate taxpayers by reducing the exemption amount by 25 percent of AMTI in excess of $150,000. Therefore, the exemption is fully phased out when AMTI exceeds $310,000 [$150,000 + ($40,000/25%)]. The AMT exemption for single individuals is reduced by 25 percent of each dollar of AMTI between $112,500 and $232,500 ($150,000-$310,000 for married filing jointly). The critical difference between the phaseout for corporate and individual taxpayers is where the phaseout begins. But for both corporate and noncorporate taxpayers, the phaseout of the $40,000 is likely to increase the effective rate of taxation.

The Social Security Bubble

The Social Security bubble causes recipients with income above certain levels to be taxed on earnings above a certain level. Under the Code, Social Security earners are taxed on the lesser of 50 percent of Social Security benefits or the excess of modified AGI over a $25,000 base for single individuals or a $32,000 base for joint filers. As with the other bubbles, the Social Security tax provisions attempt to increase the effective tax burden on Social Security receipts as income increases.

The Child Care Credit Bubble

We see a bubble in the child care credit because the rate of the credit is reduced from a maximum of 30 percent to 20 percent for taxpayers with AGI between $10,000 and $30,000. The rate of credit is reduced by 1 percent for each $2,000 increment over $10,000. So taxpayers with AGI above $30,000 receive a 20 percent credit on qualified expenses of up to $4,800 ($2,400 per qualified dependent) rather than the 30 percent rate. The proportional reduction of the 30 percent credit to 20 percent enhances progressivity by granting a more substantial credit for lower-income taxpayers.

Conclusions

The legislative push to pop the so-called bubble in the rate structure for individual taxpayers seems to be based on a misunderstanding of the statutory tax rate drop from 33 to 28 percent. The rate increase (5 percent surcharge) from 28 to 33 percent is merely a device to increase the progressivity of the individual income tax.

The phaseout of tax savings from many provisions in the code is accomplished by creating a bubble. Sometimes a tax rate surcharge is used, sometimes not. But singling out the individual income tax rate bubble as an "anomaly" is deceptive and could lead to bad tax policy.

Dallas Seminar Brings Members Together to Discuss Economic And Tax Policy Outlook

A large group of tax executives gathered June 14 in Dallas where James C. Miller III and T. Boone Pickens treated them to informative and entertaining presentations on the nation's economic and tax policy. In addition, three panels of experts gave specific talks on economics, taxation, and accounting trends.

James P. Bryant, Vice President & Director of Corporate Taxes for J.C. Penney Company, served as chairman of the program and introduced Dr. Miller, who is co-chairman of the Tax Foundation and former Director of the Office of Management and Budget under President Reagan. Miller painted a broad picture of the nation's current economic situation and made several predictions for the coming years. He sees short-term interest rates as stable, though occasionally buffeted by the Federal Reserve's reactions to inflation, but in the long term, he predicts interest rates will come down. Also on the bright side, he sees less danger of protectionist tax policy as long as the trade deficit continues its erratically downward course.

W. Michael Cox, Vice President and Economic Advisor, Federal Reserve Bank of Dallas

T. Boone Pickens, General Partner, Mesa Limited Partnership

On the worrisome side, Miller sees a surge in regulations from many government agencies, and he feels the new minimum wage jeopardizes employment levels, especially for black youth.

On the budget, Miller held forth against the necessity of a tax increase, asserting that plenty of additional federal revenue will be garnered from legislation already passed that has just recently gone into effect.

The first panel of the day presented more views of economic policy. Speakers included W. Michael Cox, Vice President and Economic Advisor, Federal Reserve Bank of Dallas; Ronald O. Durant, Senior Staff Economic Advisor, Exxon Corporation; and Jared Hazleton, Director, Center for Business & Economic Analysis, Texas A&M University.

The second panel focused on tax policy. The speakers were Paul Stein, Corporate Tax Manager, Texas Industries, Inc.; and Vernon W. Walker, Vice President & Controller, Blue Cross and Blue Shield of Texas.

The final panel on accounting trends featured Larry Dildine, Director of Tax Economics, Price Waterhouse; and Daniel J. Frisch, Principal, Economics Group, KPMG Peat Marwick.

Luncheon speaker T. Boone Pickens wrapped up the program with an address on corporate accountability to stockholders. One of America's best-known entrepreneurs, Pickens pointed out that among America's top 200 companies, stock ownership by management was only 3 percent. Pickens claimed that boosting this figure would go a long way towards making the U.S. more competitive.

James P. Bryant, Vice President & Director of Corporate Taxes, J.C. Penney Company

On the subject of taxes, Pickens complained of the tax code's complexity and instability. Complexity deters investment and innovation, and due to Congress's habit of continually rewriting the code, American businesses can not make long-range plans that take taxes into account.

Boone Pickens at left chats with Ron Bunn, Director of Corporate Development, Tax Foundation; Richard Freling, Esq., Johnson & Gibbs; Wayne Gable, President, Tax Foundation; and James C. Miller III, Co-chairman, Tax Foundation.

Ronald O. Durant, Senior Staff Economic Advisor, Exxon, U.S.A.

VIEWPOINT

With the continued expansion of international trade and the emergence of new markets overseas, how could federal tax policy best ensure U.S. corporate competitiveness?

Cyrus J. Halpern
Tax Vice President,
Federal & International Taxes, AT&T

In order to ensure U.S. corporate competitiveness, the federal budget deficit issue must be resolved in a manner that is equitable across all segments of the economy and reduces the cost of capital. Deficit reduction must be accomplished with sound tax policy rather than "quick fixes." In addition, federal tax policy should encourage rather than hinder U.S. businesses by removing or simplifying restrictive and complex provisions, including those that govern taxation of foreign source income.

A more stable tax environment which would allow business to plan for long-term projects and investments is badly needed. Incentives that currently exist, such as the research and experimentation credit, should be permanently extended.

Norman B. Ture
President, Institute for Research on the Economics of Taxation

The rapid emergence of a global economy presents every nation's businesses great opportunities to expand their operations and to enhance their productivity. Whether American business can take advantage of these opportunities will depend in significant measure on reducing the present income tax barriers to the foreign operations of U.S. multinational businesses. The foreign tax provisions of the federal income tax have long had a punitive cast; the 1986 Tax Reform Act greatly complicated these provisions and made them far more of a barrier to the free and efficient flow of capital and business ventures across national borders. American business competitiveness is impaired by our protectionist tax system. Protectionism, whether of the trade or tax variety, is at odds with efficiency, growth, and productivity advances.

The foreign tax provisions of the federal income tax cry for constructive reform. Undertaking that reform should begin with repeal of most, if not all, of the changes in those provisions enacted in the 1986 tax reform legislation.

Robert N. Mattson
Assistant Treasurer
IBM

It is often a simply expressed idea that can turn minds and effect change. We all know this idea. It was the foundation of the United States Tax Reform Act of 1986 and has spread as a worldwide tax reform movement.

The idea is that marginal tax rates, not average tax rates, govern decisions to work, save and invest. Innovation and creativity follow. In fact, it is hard to understand why the idea took so long to take hold.

The tax rate cut in the 1986 Act has had much broader and more fundamental effects than just lower U.S. federal taxes. States including California, Minnesota, New Hampshire, New York, Ohio, Oregon, Pennsylvania, South Carolina and Vermont, have reduced their high corporate tax rates following the lead of the 1986 federal corporate rate cut. But even more critical to the competitiveness of U.S. companies operating abroad, a host of foreign nations have followed the U.S. leadership culminating recently with Sweden's corporate rate cut from 52 percent to 30 percent.

Nations that move toward taxing economic activity at lower marginal tax rates have the competitive edge. The United States found its way in the 1986 Tax Reform Act by broadening the tax base in order to lower marginal tax rates. It would be an act detrimental to American living standards, and especially cruel and cynical to the long-term interests of the poor and middle class to turn back and dismiss this simple idea.

Low and even lower rates can be a lasting idea.

Viewpoint ***is designed to bring concise opinions from experts in tax and fiscal policy to the readers of*** **Tax Features.** ***Every two months a question that is currently being debated by policymakers and the media will be addressed in this column. Editorial replies are encouraged.***

Major State Taxes and Rates

as of July 15, 1990

State	Income Taxes: Corporate	Income Taxes: Individual	General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Poperty Tax
Alabama	5% (F)	2 to 5% (F)	4% (a)	11 cents	16.5 cents	X
Arizona	9.3 (F)	3.8 to 7 (F)	5 (a)	17 (b)	15 (b)	X
Arkansas	1 to 6	1 to 7	4 (a)	13.5	21	X
California	9.3 (c)	1 to 9.3 (c)	5 (a, d)	9 (b)	35	X
Colorado	5 to 5.3 (d)	5 (c)	3 (a)	20 (b)	20	X
Connecticut	11.5 (e, f)	1 to 14 (g)	8	22 (b)	40	X
District of Columbia	10 (f)	6 to 9.5	6	18	17	X
Georgia	6	1 to 6	4 (a)	7.5 + 3% of retail	12	X
Hawaii	4.4 to 6.4	2 to 10	4 (a)	19.8 to 27.5	40% of wholesale	
Idaho	8	2 to 8.2	5	18	18	X
Illinois	4.8 (h)	3	6.25 (a)	19	30	X
Indiana	3.4 (i)	3.4	5	15	15.5	X
Iowa	6 to 12 (F, j)	.4 to 9.98 (F,c)	4 (a)	20	31	
Kansas	4.5 (f)	3.65 to 8.75 (k)	4.25 (a)	16 (b)	24	X
Kentucky	3 to 7.25	2 to 6 (F)	6 (a)	15 (l)	3	X
Louisiana	4 to 8 (F)	2 to 6 (F)	4 (a)	20	16	X
Maine	3.5 to 8.93	2 to 8.5	5	17	31 (b)	X
Maryland	7	2 to 5	5	18.5	13	X
Massachusetts	9.5 (m)	5.95 (n)	5	17 (b)	26	X
Michigan	2.35	4.6	4	15	25	X
Minnesota	9.5 (b, c)	6 to 8.5 (o)	6 (a)	20	38	X
Mississippi	3 to 5	3 to 5	6	18 (d)	18	X
Missouri	5 to 6.5 (F, e)	1.5 to 6 (F)	4.225 (a, d)	11	13	X
Nebraska	5.17 to 7.24 (b)	2 to 5.9 (b)	5 (a)	21.9 (l)	27	X
New Jersey	9 (f)	2 to 7	7	10.5	40	X
New Mexico	4.8 to 7.6	1.8 to 8.5	5	16	15	X
New York	9 (c, f)	4 to 7.875 (d, p)	4 (a)	8	39	
North Carolina	7	6 to 7	3 (a)	21.5	2	X
North Dakota	3 to 10.5 (F, c)	2.67 to 12 (F, q)	5	17	30 (d)	X
Ohio	5.1 to 8.9	.743 to 6.9	5 (a)	20	18	X
Oklahoma	6	.5 to 10 (F, k)	4.5 (a)	16	23	
Pennsylvania	8.5	2.1	6 (a)	12	18	X
Rhode Island	9	22.96% of modified Federal income tax	7 (d)	20 (l)	37	X
South Carolina	5	3 to 7 (d)	5 (a)	16	7	X
Tennessee	6	6 (g)	5.5 (a)	20	13	
Utah	5	2.55 to 7.2 (F)	5 (a)	19	23	X
Vermont	5.5 to 8.25	28% of Federal income tax (d)	4	15 (d)	17	X
Virginia	6	2 to 5.75	3.5 (a)	17.5	2.5	X
West Virginia	9.3 (d)	3 to 6.5 (c)	6	15.5	17	X
Wisconsin	7.9	4.9 to 6.93	5 (a)	21.5 (l)	30 (e)	X
Florida	5.5 (c)		6 (a)	4 (r)	33.9	X
Nevada, South Dakota, Texas, Washington, Wyoming	These 5 states have no corporate income tax	These 7 states have no individual income tax	5.75 (a)	18	35 (d)	X
			4 (a)	18	23	
			6.25 (a)	15	41	
			6.5 (a)	22 (b, l)	34 (d)	X
			3 (a)	9 (l)	12	X
Alaska	1 to 9.4		These	8	29	X
Delaware	8.7	3.2 to 7.7 (F)	5 states	16 (b)	14 (b)	
Montana	6.75 (f, s)	2 to 11 (F)	have no	20	18	X
New Hampshire	8	5 (g)	general	16	25	X
Oregon	6.6	5 to 9 (F)	sales tax	18 (b)	28	X

(X) Indicates state levies a property tax.
(F) Allows federal income tax as a deduction.
(a) Local taxes are additional.
(b) Future increases scheduled under current law.
(c) Alternative minimum tax is imposed.
(d) Future reductions scheduled under current law.
(e) Alternative methods of calculation may be required.
(f) Corporate surtax is imposed. Connecticut – 20%, District of Columbia – 5%, Kansas – 2.25%, New Jersey – .375%, New York – 15%, Montana – 5%.
(g) In Connecticut, New Hampshire, and Tennessee, rates apply to income from dividends and interest. Capital gains are taxed at 7% in Connecticut.
(h) Additional 2.5% personal property replacement tax imposed.
(i) A supplemental net income tax is imposed at 4.5%.
(j) Franchise tax is 5% of taxable net income.
(k) In Kansas and Oklahoma, the higher rates apply to taxpayers deducting Federal income tax.
(l) Tax rate is periodically adjusted administratively.
(m) Excise tax is imposed equal to the greater of $455.
(n) Tax of 12% on income derived from interest, dividends, and capital gains.
(o) Additional tax is imposed on income over specified levels, varying with filing status.
(p) Qualified taxpayers may elect to pay alternative taxes at varying rates.
(q) Optional tax of 14% of taxpayers federal income tax liability.
(r) In addition, Florida imposes a 6.9 cent sales tax on gasoline.
(s) 7% rate for corporations using water's edge apportionment.

Source: Compiled by Tax Foundation from survey of state revenue offices and data reported by Commerce Clearing House through June 15, 1990.

FY1989 State Taxes Rise $20 Billion; Increase 7.5 Percent Over FY1988

State tax revenues have soared nearly $20 billion in fiscal year 1989, a 7.5 percent increase from last year. Revenues for states reached a record high of $284 billion, up $19.9 billion from $264.1 billion in FY 1988. Increased rates in sales, gasoline, and corporate and personal income over the past years have led to new revenue highs.

Sales Tax Is Biggest Haul

For FY1990, more than ten states have increased their general sales tax rates. Overall, general sales taxes generate the most revenue for states. They provided $93.4 billion of revenue, 32.9 percent of the total revenue for the 50 states. Connecticut still leads the nation with an 8 percent sales and use tax, followed closely by New Jersey and Rhode Island (7 percent), Washington (6.5 percent) and Illinois and Texas (6.25 percent).

On the lower end of the scale, Colorado, North Carolina, and Wyoming levy a 3 percent sales tax. No state general sales tax is imposed in Alaska, Delaware, Montana, New Hampshire, and Oregon.

Personal Income Tax

Personal income tax was the second most productive revenue source, contributing $88.7 billion in FY'89, for 31.2 percent of total tax receipts, a 10.7 percent increase from fiscal 1988 receipts. Income tax revenues have increased more in fiscal 1989 than any other tax revenue source. New Jersey recently imposed the most notable increase in individual income rates for 1990 by raising the top rate from 3.5 percent to 7 percent.

The tax rate schedules are progressive in all but six of the 43 states that levy a broad-based personal income tax. Colorado, Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate regardless of income level. In Rhode Island and Vermont, income taxes are levied as a percentage of Federal individual income tax obligations.

Corporate Income Tax

Corporate income tax proved to be another major revenue raiser for the states, raising $23.9 billion. The maximum corporate income tax rate is highest in Iowa (6 to 12 percent), Connecticut (11.5 percent), and North Dakota (3 to 10.5 percent). (This ranking omits several states which have higher income tax rates but allow for deductions.) Five states continue to dispense with the corporate income tax as well as the individual income tax - Nevada, South Dakota, Texas, Washington, and Wyoming. Florida and Alaska have no individual income tax.

Motor Fuels

Taxes on motor fuels contributed 6.3 percent to total tax receipts. Gasoline taxes are currently the highest in Hawaii (where combined state-local rates range from 19.8 to 27.5 cents per

See State Taxes on page 8

PRESIDENT'S MESSAGE

Capping Deductions Unlikely To Solve Budget Deficit

Wayne Gable

The Tax Foundation has long been known for including all levels of government in its analyses of taxing and spending. Therefore, it is not surprising that as the budget summit churned out ideas for increasing federal revenues, people should look to the Foundation for the state-level effects of these proposals. Recently the capping of state and local income tax deductibility was reported to be a likely choice of the summiteers.

The Foundation responded by publishing in the *Wall Street Journal* a breakdown of how much money each state collects per capita using state and local income taxes. The wide disparity of these figures separates the states into clear categories of winners and losers should the deduction be capped or eliminated. Naturally, the residents of states which rely heavily on state and local income taxes for revenue are the losers who will pay the bulk of any new federal revenue raised by limiting the deduction. Hardest hit among them would be the residents of the District of Columbia, New York, and Massachusetts. These same states are already at or near the top of the list for total per capita federal taxes; so the loss of state/local deductibility would be doubly burdensome.

The winners on this issue are easy to find. Seven states levy no state or local income taxes, so the residents of Florida, Nevada, South Dakota, Texas, Washington, Wyoming and Alaska would not pay a cent in extra tax.

We have analyzed the deduction for property taxes in the same manner. Residents of Alaska, the District of Columbia, and New Hampshire have the highest per capita property taxes and would be the big losers should its deductibility be capped or eliminated. In fact, thirty-eight states collect more per person in property taxes than in state and local income taxes. The states which rely the least on property tax are Alabama, New Mexico, and Arkansas.

The prospect of paying higher taxes by losing deductions is irritating in itself to any taxpayer who uses them, especially if he lives in a high-tax state where the deduction is substantial. But to add insult to injury, the summiteers claim this tax increase has the noble motive of lowering the deficit. As I mentioned in this column in May, budget summits have failed throughout the 1980s. They have always included tax increases and promised spending restraints, but while the tax increases go immediately into effect, the spending restraints come to naught, and the deficit rises. In fact, the years which were not preceded by budget summits, 1984 and 1987, saw huge improvements in the deficit.

Now that the summit talks are showing signs of breaking down, perhaps we have a greater chance of deficit reduction than when they were "making progress." In any event, the Tax Foundation will continue to bring the facts to bear on taxes and spending at the federal, state, and local levels.

State Taxes from page 7

gallon), Connecticut and Washington (22 cents), and Nebraska (21.9 cents) . Florida levies the lowest rate , 4 cents per gallon; however, gasoline is also subject to a 6.9 cent general sales tax. New York and Alaska follow closely with an 8 cent rate.

Cigarette Taxes

Cigarette taxes also make a notable contribution to state tax revenues. In FY'89, states collected $5 billion of their total revenues from tobacco product excises. Connecticut and New Jersey top the ranks with a 40 cent rate per pack of twenty cigarettes. North Carolina levies the lowest rate at 2 cents.

See table on page 6 for more detail.

Now Available

A new Tax Foundation *Special Report* entitled *Survey of State Tax Rates and Collections*, 4 pp. $10 + $2 postage/handling.

Mark Your Calendars

The Tax Foundation's
42nd Annual Conference
and
53rd Annual Dinner
will be held at the
Waldorf-Astoria Hotel
in New York City
on December 5, 1990

International Investment Subject of September Tax Foundation Seminar

Congressmen Hank Brown (R-Co) and Phil Crane (R-IL), both of the House Ways and Means Committee, will speak at an upcoming Tax Foundation seminar entitled "Assessing U.S. Tax Policies Toward International Investment — An Opportunity for Change." The half-day seminar will be held the afternoon of September 25, 1990, at the Washington Court Hotel on Capitol Hill. An informal cocktail reception will follow.

Dr. Gary Hufbauer, professor of international financial diplomacy at Georgetown University, will follow Congressman Brown's keynote address with an economic overview of the issues.

The early afternoon session will concentrate on the U.S. tax treatment of American investment abroad. At press time, three speakers were confirmed: Raymond Haas, International Tax Partner, Ernst & Young; Dick Hammer, International Tax Partner, Price Waterhouse; and John F. Brussel, International Tax Director, AT&T.

The second session will examine the tax treatment of foreign investment coming into the U.S. Confirmed to speak are: Elliot L. Richardson, Senior Partner, Milbank, Tweed, Hadley & McCloy; James M. Carter, Senior Tax Counsel, ICI Americas; Bruce R. Bartlett, Deputy Assistant Secretary for Economic Policy; U.S. Department of the Treasury; Peter Barnes, Deputy Assistant International Tax Counsel, U.S. Department of the Treasury; Catherine T. Porter, Partner, Miller & Chevalier, Chartered; and Richard Pratt, Economic Counselor, Embassy of Great Britain.

For more information, please call Paul Merski or Sedef Onder at 202-863-5454.

Tax Features

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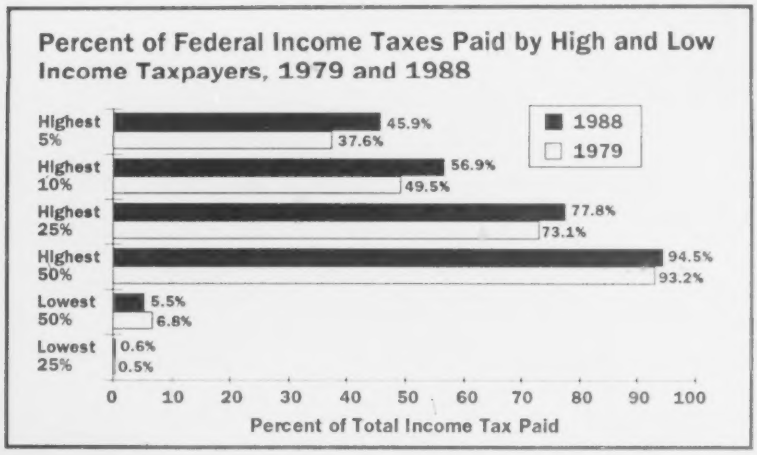
Tax Features

U.S. Income Tax Burden: Top 10% Pays Over Half; Top Half Pays Over 90%

The top earning half of the population continues to pay well over 90 percent of the federal individual income tax bill, according to analysis of the most recent 1988 IRS tax return data. 1988 data reflect the first year for which most provisions of the Tax Reform Act of 1986 (TRA'86) were fully implemented. Despite all the major tax legislation witnessed over the past decade, the top earning half's share of the tax load has varied less than 2 percent — from a low of 92.6 percent in 1982 to a high of 94.5 percent in 1988.



The federal income tax system remains progressive as the top ten percent of earners continue to shoulder a larger share of the total tax burden, up 7.4 percentage points, from 49.5 percent in 1979 to 56.9 percent in 1988. This growth in tax burden has occurred despite the alleged upper income bias of the tax cuts and rate reductions under the Economic Recovery Tax Act of 1981 (ERTA), and TRA'86.

Growth in the income base itself has been increasing faster at the upper end of the income scale, resulting in increased income tax receipts from top earners. The 110 million returns filed for tax year 1988 reported a sharp increase in adjusted gross income of over $323 billion, largely due to the fact that a number of income exclusions and adjustments were either

See High-Low on page 4

Tax Foundation

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FRONT BURNER

Pension Simplification: Is It Attainable?

Sen. David Pryor

Pension simplification is both desirable and achievable this year. The Finance Subcommittee on Private Retirement Plans has held two hearings to discuss pension simplification. The Ways and Means Committee staff has made recommendations to Chairman Rostenkowski on simplification proposals, including pension changes. Finally, on July 25, Representative Chandler and I introduced companion bills, S. 2901 and H.R. 5362, the Employee Benefit Simplification Act, as a first step toward improving the administrability of the nation's pension laws.

The broad Congressional interest has convinced many early doubters that the tax writing Committees are willing to undertake the laborious task of reviewing the Internal Revenue Code pension rules and, more importantly, are willing to grapple with the reality of drafting improvements to the system.

Today, there are two major questions in the minds of most benefits watchers. First, does the Employee Benefit Simplification Act really advance the cause of simplification? Second what is the likelihood of the Congress acting this year?

A quick look at the Employee Benefit Simplification Act would lead some to conclude that it might add to the complexity of the system: it totals 67 pages. However, a closer scrutiny shows that the bill accomplishes significant simplification in a number of areas.

S. 2901/H.R. 5362 replaces the complex distribution rules of present law with a simple rule that allows an employee to roll over any

See Pryor on page 2

David Pryor, Democratic Senator from Arkansas, serves on the Senate Committee on Finance.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Pryor from page 1

portion of a distribution, provided the rollover is accomplished within 60 days. At the most basic level, this change will eliminate half of the statutory language dealing with pension distribution and many pages of regulations. But more importantly, this change will eliminate much of the confusion for employee participants on what is or is not allowed when a participant receives a lump sum distribution.

"The broad Congressional interest has convinced many early doubters that the tax writing Committees are willing to undertake the laborious task of reviewing the Internal Revenue Code pension rules and . . . grappl[ing] with the reality of drafting improvements to the system."

Additionally, the bills would nullify the Treasury regulations on leased employees and replace them with a much narrower "control" test. The Treasury regulations use a "historically performed" test, which considerably increases the universe of workers an employer must consider as leased employees. The regulations are causing employers to expend hundreds of thousands of dollars on data collection without providing any more certainty that they are complying with the regulations. The control test of the bills would considerably narrow the pool of workers that might be considered leased employees, and, therefore, the proposed change would cut costs and provide more certainty to employers.

Another important component of the bill is a safe harbor for section 401(k) plans. The present rules governing 401(k) plans require costly testing every year to measure the deferrals of the high paid employees against the deferrals of the rank and file. The bills contain a safe harbor from this yearly testing for pension plans that provide generous benefits to the rank and file. This provision provides real relief to plans fitting within its requirements. It should cut costs for many plans, and encourage others to increase benefits to their employees in order to fit within the safe harbor.

"Today, there are two major questions in the minds of most benefits watchers. First, does the Employee Benefit Simplification Act really advance the cause of simplification? Second what is the likelihood of the Congress acting this year?"

The bills' provisions are numerous, but overall, the general character of these changes is to draw simple bright line tests for employees with our compromising pension policy. These changes include simplifying the definitions of compensation and highly compensated employees, modifying the minimum participation requirements to focus the rules on the areas where abuses are more likely to occur, and changing the rules governing Simplified Employee Plans to encourage their use by small employers.

"The bills will not make the pension rules simple, but they will certainly make them simpler. We must clearly move in the direction of making policy clearer and more administrable; otherwise, we risk seeing a long term decline in retirement savings at the same time that changing demographics make it imperative that we save more."

All of these changes add up to real simplification. Most of them have been drafted to minimize disruption and the need for plan amendments. Where necessary, effective dates have been delayed to help employers to adjust to change. The bills will not make the pension rules simple, but they will certainly make them simpler. We must clearly move in the direction of making policy clearer and more administrable; otherwise, we risk seeing a long term decline in retirement savings at the same time that changing demographics make it imperative that we save more.

But is simplification achievable this year? Like all tax proposals before Congress this year, pension simplification is tied to the budget summit, like Captain Ahab to the great white whale. If the summit sinks below the waters, then pension simplification will have to wait for the 102nd Congress for revival. However, if the summiteers are able to keep an agreement afloat and the ground rules established by the summit permit, Congress is likely to address pension simplification this year. The cause is certainly helped by having a majority of the Finance Committee as cosponsors, including Chairman Bentsen.

"If the summiteers are able to keep an agreement afloat and the ground rules established by the summit permit, Congress is likely to address pension simplification this year. The cause is certainly helped by having a majority of the Finance Committee as cosponsors, including Chairman Bentsen."

In addition, there is the very important consideration of revenue loss. Although the Joint Committee on Taxation has not yet completed a revenue estimate for the bill, we expect to receive them soon and are hopeful that the effect on the budget will not be significant. Moreover, to act on pension simplification this year, the summit agreement will have to provide some leeway for addressing non-budget issues. If the Employee Benefit Simplification Act can overcome these two potential hurdles, then it should have a good chance of being included in the budget agreement.

VIEWPOINT

With an extension of the tax credit for R&D once again under consideration, is it also time to simplify the administrative burden?

Research and development (R&D) expenditures are more than corporate operating expenses; they are an investment in future technological advances, in the competitiveness of U.S. industry, and ultimately in society as a whole.

The most critical legislative problem that R&D faces today is the uncertainty surrounding the continued existence of these incentives. The Omnibus Budget Reconciliation Act of 1989 extended the R&D credit through September 1990. Whether or not it will be extended again is certainly not guaranteed, especially given the current fiscal climate. Unfortunately, the government's short-term revenue considerations and corresponding R&D tax policy – i.e., the lack of a permanent credit – frustrate the long-term planning of research expenditures.

Given the integral part R&D plays in our country's economic development, it is surprising how uncertain and inconsistent its treatment in the tax code and by regulations, including the lack of a permanent credit, has been during the past decade. The rules governing application of the R&D incentives are quite complex and arguably more burdensome than necessary for an appropriate blend of tax policy and administrative practicality.

Allow me to illustrate this point with an example from my own experience with the taxation of R&D. For somewhat apparent reasons, when viewed from their single perspective, different authoritative bodies, such as regulatory agencies, have created significantly different definitions as to what R&D activities and expenses constitute "research and development" for their purposes. So, for instance, there are GAAP rules for measuring R&D for accounting purposes, government contract accounting rules for eligible R&D on government contracts, specific industry guidelines for R&D in certain industries, and a multiplicity of tax rules.

More specifically, however, once we focus on the tax rules, their construction seems to have been with limited reference to other definitional sources. Moreover, the tax rules rely on different definitions for different statutory applications. For example, the deduction under Section 174 is fairly broad, but the "qualified research" definition for the R&D credit of Section 41 is much more restrictive and only applicable to a subset of expenses. In addition, during the last decade these definitions have been changed both statutorily and by regulation. For instance, it was only last year that final regulations were issued for applying many aspects of the credit, and these regulations incorporated some brand new interpretations retroactive to the original effective dates in 1981.

Imagine then the plight of a manufacturer with some government contracts, for example, who must maintain exhaustive records for distinguishing between the costs on a project-by-project basis that meet the varying definitions: GAAP for financial statements, government contracting regulations for government contracts, Reg. Section 1.174 for R&D deductions, and Section 41 and the regulations thereunder for the R&D credit. Of course, I've not mentioned what are perhaps the most important research numbers for this hypothetical manufacturer: the management reports used to properly administer the research project, which obviously could require an entirely different set of records.

Robert L. Black, Ph.D., CPA
National Tax
Coopers & Lybrand

While the objectives of having different defintions may make sense on a separate-purpose basis, the multiple definitions, when applied concurrently to the same projects, only create administrative confusion and inefficiencies. And the problem is not just within the private sector; IRS agents have similar difficulties with interpreting and applying the myriad of R&D rules.

The Tax Foundation recently conducted a seminar designed to illuminate the issues that companies face regarding research and development. The proceedings are now available, and as you read through the presentations of these lawyers, scholars, businessmen and government representatives, you may be surprised to learn that a company often reaps little direct or immediate benefit from its R&D spending, and that too frequently there may be no benefit at all. In that the credit percentage has been eroded over the years and the foreign allocation rules may produce a higher worldwide effective tax rate for U.S. multinational conducting research, it may seem surprising, from a tax standpoint, that companies commit the level of resources to R&D that they do.

Isn't it about time that we reevaluated our R&D tax policy to help ensure that the tax incentive effects are maximized while the administrative burden and uncertainty are minimized?

Viewpoint is designed to bring to the readers of Tax Features *concise opinions from experts in tax and fiscal policy on questions that are currently being debated by policymakers and the media. Editorial replies are encouraged.*

High-Low from page 1

repealed or limited by the new law. Adjusted gross income rose to over $3 trillion for the first time. Taxpayers reported receiving larger amounts of certain types of income, especially partnership and S Corporation net income, property, dividend, pension and annuity income. Taxable income from Social Security income showed a hefty 15.8 percent increase over 1987, reaching $14.5 billion.

The number of returns showing itemized deductions dropped 3.8 million. This was largely due to the increased standard deduction allowed for 1988 and the continued phase-out of "passive losses." The deductibility phase-out of personal interest helped foster a $13.6 billion increase in taxable interest income.

At the bottom line, 1988 total individual income tax rose a hefty 12.7 percent over 1987 for a record $416.1 billion take. At the aggregate, taxes as a percentage of adjusted gross income increased slightly from 13.3 percent to 13.4 percent of AGI. A greater proportion of income was taxed at the highest rate in 1988 because much of the increase in AGI occurred in the higher income classes. This also resulted in the upper income groups' paying a greater percentage of the overall tax collections in 1988.

The top 5 percent of earners nearly doubled their average tax payment, from $17,407 in 1979 to $34,788 in 1988. The top 10 percent paid an average $21,573, 88 percent higher than in 1979. While this group of only 11 million earners paid well over half the total income taxes in 1988, their adjusted gross income ranged down to $58,368, not exactly "fat cat" status. It still takes millions of middle and upper-middle income taxpayers to pay the bulk of the total income tax bill.

Federal Income Taxes Paid by High and Low-Income Taxpayers, 1979 and 1988[a]

Adjusted Gross Income Class	Income Level		Percent of Tax Paid		Average Tax	
	1979	1988	1979	1988	1979	1988
Highest 5%	$39,000 or more	$73,757 or more	37.6%	45.9%	$17,407	$34,788
Highest 10%	32,710 or more	58,368 or more	49.5	56.9	11,456	21,573
Highest 25%	21,760 or more	35,609 or more	73.1	77.8	6,769	11,797
Highest 50%	11,870 or more	18,145 or more	93.2	94.5	4,315	7,163
Lowest 50%	11,869 or less	18,144 or less	6.8	5.5	313	416
Lowest 25%	5,565 or less	7,006 or less	0.5	0.6	46	87
Lowest 10%[b]	2,212 or less	2,178 or less	c	c	9	22

[a] Data for 1988 are preliminary.
[b] Includes returns showing no adjusted gross income.
[c] Less than .07 percent.
Source: Tax Foundation computations based on Statistics and Income, Internal Revenue Service, U.S. Department of the Treasury.

1988 Income Tax Data

Adjusted Gross Income Class	Total Individual Returns (thousands)	Total Adjusted Gross Income ($billions)	Percent of Adjusted Gross Income	Average Tax Rate
Highest 5%	5,490	$894.7	28.9%	21.3%
Highest 10%	10,981	1,223.0	39.5	19.4
Highest 25%	27,452	1,951.7	63.0	16.6
Highest 50%	54,904	2,673.5	86.3	14.7
Lowest 50%	54,904	423.8	13.7	5.4
Lowest 25%	27,452	71.1	2.3	3.3
Lowest 10%[a]	10,981	-17.1	-	-

[a] Includes returns showing no adjusted gross income.
Source: Tax Foundation computations based on Statistics and Income, Internal Revenue Service, U.S. Department of the Treasury.

Mark Your Calendars

The Tax Foundation's
42nd Annual Conference
and 53rd Annual Dinner
Waldorf-Astoria Hotel
in New York City
on December 5, 1990

IRET Seminar To Focus on U.S. Foreign Tax Policy

On October 4, 1990, the Institute for Research on the Economics of Taxation will host an all-day conference in conjunction with Arthur Andersen on U.S. tax policy's current treatment of foreign investment. See schedule below for all pertinent information.

"U.S. Foreign Tax Policy: America's Berlin Wall"

October 4, 1990
Washington Court Hotel
Washington, DC

8:00 **Registration & Continental Breakfast**

8:30 **Welcome & Opening Remarks**
Norman Ture, President, IRET

8:40 **Challenges & Opportunities for American Business & for Public Policy in an Expanding World Economy**
Overview
CEO (to be announced)

9:15 **Economic Potential in Expanding World Markets**
J.D. Foster, Legislative Assistant, Tax Policy, Sen. William Armstrong (R-CO)

10:00 **Problems & Opportunities Arising from EC'92 and the Democratization of Eastern Europe**
Congressman Tom Campbell (R-CA) (inv.)
Murray Schlussel, Asst. General Counsel, International Tax, Ford Motor Co.

10:45 **Break**

11:00 **Tax Policy to Address the Challenges & Opportunities of the Growing World Marketplace**
Norman B. Ture, President, IRET
George Carlson, Director, Economics of Taxation, Arthur Andersen

12:30 **Luncheon Address — Tax Policy to Enhance American Competitiveness**
The Honorable Robert Mosbacher, Secretary of Commerce (inv.)

2:00 **U.S. Foreign Tax Policy and American Business Competitiveness in the Global Marketplace**
Overview
Andre P. Fogarasi, Managing Director, Office of Federal Tax Services, Arthur Andersen
Richard A. Gordon, Director, International Tax Services, Arthur Andersen

2:30 **High-Tech Manufacturing**
Richard Ise, Vice President & Tax Counsel, SmithKline Beecham (inv.)
Bob Perlman, Vice President, Tax, Licensing and Customs, Intel Corp.

3:00 **Other Manufacturing**
John L. Loffredo, Chief Tax Counsel, Chrysler Corporation
Albert E. Germain, Vice President - Taxes and Tax Counsel, Alcoa

3:45 **Service Industries**
Noelle Harwerth, Vice President & Chief Tax Officer, Citicorp

4:15 **Adjourn**

To register, call Kate Watson at 202-347-9570

Tax Foundation Forms Research Planning Groups

Three Tax Foundation program committee members will play a more active role in guiding the Foundation's research. James P. Bryant, vice president and director of corporate taxes at J.C. Penney Company, will be the head of a task force exploring new opportunities for research into tax administration, compliance and simplification. Mr. Bryant was instrumental in sponsoring the Foundation's recent seminar in Dallas, where two panel discussions addressed aspects of the Internal Revenue Code's complexity and current accounting trends.

Haskell Edelstein, senior vice president and general tax counsel for Citicorp/Citibank, U.S.A., will head up a task force guiding the Foundation's research effort in the area of state and local fiscal policies.

The third area of research for which the Foundation is forming a task force is multinational taxation, with John J. Ross, general tax counsel for Chevron Corporation, as its head. Taxation of multinationals will be addressed at the Foundation's upcoming seminar on September 25.

By working with the program committee's two chairmen, Robert F. Hannon, retired director of government relations for Arthur Young & Company, and Glenn W. White, retired director of tax department and assistant secretary at The Dow Chemical Company, these tax executives will help the Foundation fulfill its mission of monitoring taxation and fiscal policy at all levels of government, a task rendered all the more difficult by the tremendous complexity of the code.

Thomas M. Macioce

Thomas M. Macioce, financial leader and longtime friend of the Tax Foundation, died August 3 at Columbia-Presbyterian Medical Center. He was 71 years old and lived in Brookville, NY.

Former chairman and chief executive officer of Allied Stores, Mr. Macioce spent 27 years with the company and was credited with its resurgence during the 1970s.

PRESIDENT'S MESSAGE

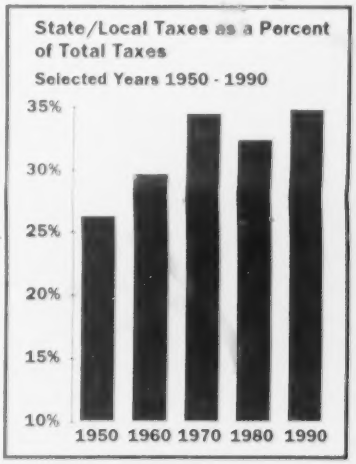
Growing State and Local Taxes Demand More Public Scrutiny

Wayne Gable

An oft-repeated statistic here in Washington warns that federal taxes as a percentage of GNP will break the 20 percent barrier in 1990. Only two years in the last forty, 1968 and 1981, have seen federal spending dominate the economy to this extent. This trend is alarming indeed, but Americans need not look as far as Washington for an example of growth in government.

State and local government taxes have increased much faster than federal taxes over that same forty-year period, from 6.10 percent of GNP in 1950 to 10.75 percent in 1990. State and local taxes now constitute over a third of the total taxes collected (see chart below). This surge should prompt attention from the national media, but state-level tax issues are difficult to cover from a national perspective. Composed of fifty different state histories and hundreds of different stories within each of those fifty, state-level taxation cannot be analyzed in a sound-bite. The complexity of state taxes even imposes itself on federal taxes, as it did in the recent controversy over a proposal to eliminate the deduction for state and local income taxes. Clearly this would constitute a hart hit on citizens whose states rely most on that particular tax relative to states with no individual income tax.

Since tax increases at the state and local levels are presented as solutions to specific problems that citizens are painfully aware of, such as inadequate education, health care and corrections, these taxes have risen steadily. If these states now had excellent schools, good hospitals and efficient prisons, then tax increases might enjoy more popular support. But since the numerous tax increases don't seem to have fixed these problems, perhaps the next time a tax increase is proposed to solve a problem, taxpayers will demand solutions that do not require more tax revenue.



The Tax Foundation has just issued a state by state survey of state tax collections and rates. It tells how much per $1,000 of personal income each state exacts in tax collections. Then in examining tax collections by type, it breaks out the components of state tax collections, sales tax, personal income tax, etc. Earlier this year in our annual Tax Freedom Day report, we noted that the average American worked 43 days simply to earn enough to pay his state and local taxes. This average encompassed a range from 23 days in New Hampshire to 60 days in Hawaii.

As the burden of state taxes weighs more and more heavily on taxpayers, they will need more and more information to make their decisions. The Tax Foundation recognizes that state tax issues are exceedingly complex and require more and better research. We will continue to bring out accurate, timely state-by-state analysis to fill that need.

Tax Foundation Seminar Addresses U.S. Tax Treatment Of Inbound and Outbound Foreign Investment

Congressmen Hank Brown (R-CO) and Phil Crane (R-IL), both of the House Ways and Means Committee, will speak at the Tax Foundation's September 25 seminar entitled "Assessing U.S. Tax Policies Toward International Investment — An Opportunity for Change." The half-day seminar (see schedule below) will be followed by an informal cocktail reception.

The seminar is divided into four panel discussions, two on U.S. tax policy toward investment coming into the United States from foreign countries, and two on how we tax investments abroad by U.S.-based firms. The latest thinking from the foremost international tax experts will be brought to bear on the daunting challenge posed by the globalization of the world economy to U.S. tax policy.

For more information, please call Paul Merski or Cynthia Herrle at 202-863-5454.

"Assessing U.S. Tax Policies Toward Foreign Investment – An Opportunity for Change"

September 25, 1990, at the Washington Court Hotel on Capitol Hill in Washington, DC

12:00 Registration/Light Fare

12:30 Welcome
Wayne Gable, President, Tax Foundation

Keynote Address
Congressman Hank Brown (R-CO), House Ways and Means Committee

Issue Overview
Edward M. Graham, Senior Fellow, Institute for International Economics

1:00 Session #1: Tax Treatment of U.S. Investment Abroad

Panel Chairman: David Crowe, Partner, Caplin & Drysdale

Raymond Haas, International Tax Partner, Ernst & Young

Murray Schlussel, Asst. General Counsel, International Tax, Ford Motor Co.

Panel Chairman: Robert Mattson, Assistant Treasurer, IBM

Richard M. Hammer, International Tax Partner, Price Waterhouse

B. Anthony Billings, Tax Foundation Senior Research Fellow & Associate Professor of Accounting, Wayne State University

John F. Brussel, Tax Director - International, AT&T

2:30 Break

2:45 Session #2: Tax Treatment of Foreign Investment in the U.S.

Panel Chairman: Robert Ashby, Asst. Vice President, Taxes, Northern Telecom Inc.

Congressman Philip M. Crane (R-IL), House Ways and Means Committee: Trade, Ranking Minority Member

Elliot L. Richardson, Senior Partner, Milbank, Tweed, Hadley & McCloy

James Merle Carter, Senior Tax Counsel, ICI Americas

Bruce R. Bartlett, Deputy Asst. Secretary for Economic Policy, U.S. Department of the Treasury

Panel Chairman: John Wilkins, Partner, Coopers & Lybrand

Catherine T. Porter, Partner, Miller & Chevalier, Chartered

Peter Barnes, Deputy International Tax Counsel, U.S. Department of the Treasury

Harrison J. Cohen, Legislation Counsel, Joint Committee on Taxation

Richard Pratt, Economic Counsellor, Embassy of Great Britain

5:15 Cocktail Reception

To register, call Cynthia Herrle at 202-863-5454

Tax Features

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